

MFS SPECIAL VALUE TRUST
Form N-CSRS
June 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF
REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-05912

MFS SPECIAL VALUE TRUST

(Exact name of registrant as specified in charter)

111 Huntington Avenue, Boston, Massachusetts 02199

(Address of principal executive offices) (Zip code)

Susan S. Newton

Massachusetts Financial Services Company

111 Huntington Avenue

Boston, Massachusetts 02199

(Name and address of agents for service)

Registrant's telephone number, including area code: (617) 954-5000

Date of fiscal year end: October 31

Date of reporting period: April 30, 2015

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ITEM 1. REPORTS TO STOCKHOLDERS.

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SEMIANNUAL REPORT

April 30, 2015

MFS® SPECIAL VALUE TRUST

MFV-SEM

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Managed Distribution Policy Disclosure

The MFS Special Value Trust's (the fund) Board of Trustees has adopted a managed distribution policy. The fund seeks to pay monthly distributions based on an annual rate of 10.00% of the fund's average monthly net asset value. The fund's total return in relation to changes in net asset value is presented in the Financial Highlights. You should not draw any conclusions about the fund's investment performance from the amount of the current distribution or from the terms of the fund's managed distribution policy. The Board may amend or terminate the managed distribution policy at any time without prior notice to fund shareholders.

With each distribution, the fund will issue a notice to shareholders and an accompanying press release which will provide detailed information regarding the amount and composition of the distribution and other related information. The amounts and sources of distributions reported in the notice to shareholders are only estimates and are not being provided for tax reporting purposes. The actual amounts and sources of the amounts for tax reporting purposes will depend upon the fund's investment experience during the remainder of its fiscal year and may be subject to changes based on tax regulations. The fund will send you a Form 1099-DIV for the calendar year that will tell you how to report these distributions for federal income tax purposes.

Under a managed distribution policy the fund may at times distribute more than its net investment income and net realized capital gains; therefore, a portion of your distribution may result in a return of capital. A return of capital may occur, for example, when some or all of the money that you invested in the fund is paid back to you. A return of capital does not necessarily reflect the fund's investment performance and should not be confused with yield or income. Please refer to Tax Matters and Distributions under Note 2 of the Notes to Financial Statements for information regarding the tax character of the fund's distributions.

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MFS® SPECIAL VALUE TRUST

New York Stock Exchange Symbol: **MFV**

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NOT FDIC INSURED MAY LOSE VALUE NO BANK GUARANTEE

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LETTER FROM THE CHAIRMAN

Dear Shareholders:

Global economic expansion slowed in early 2015 as the pace of U.S. growth decelerated sharply. Harsh weather hurt U.S. domestic demand, and a strong dollar

made exports more expensive. Also contributing to weakness were a slow, tentative eurozone economic recovery, a steady downturn in China's pace of growth and ongoing sluggishness in Japan.

Asian and European central banks are making concerted stimulus efforts. The European Central Bank's quantitative easing program shows early signs of gaining traction. The People's Bank of China has introduced a series of targeted monetary policy actions. The Bank of Japan remains focused on its target of 2% consumer price inflation.

With little sign of inflation, the U.S. Federal Reserve has remained accommodative in the face of these global headwinds, though interest rate increases are expected to begin later this year.

The world's financial markets have become increasingly complex in recent years. Now more than ever, it is important to understand companies on a global basis. At MFS®, we believe our integrated research platform, collaborative culture, active risk management process and long-term focus give us a research advantage.

As investors, we aim to add long-term value. We believe this approach will serve you well as you work with your financial advisor to reach your investment objectives.

Respectfully,

Robert J. Manning

Chairman

MFS Investment Management

June 16, 2015

The opinions expressed in this letter are subject to change and may not be relied upon for investment advice. No forecasts can be guaranteed.

Table of Contents**PORTFOLIO COMPOSITION****Portfolio structure (i)**

Top ten holdings (i)	
Duke Energy Corp.	1.6%
JPMorgan Chase & Co.	1.6%
NASDAQ OMX Group, Inc.	1.5%
CVS Health Corp.	1.5%
Travelers Cos., Inc.	1.4%
Verizon Communications, Inc.	1.4%
U.S. Bancorp	1.3%
Johnson & Johnson	1.3%
Nestle S.A., ADR	1.2%
Merck & Co., Inc.	1.2%
Equity sectors	
Financial Services	8.9%
Health Care	4.8%
Consumer Staples	3.9%
Industrial Goods & Services	3.3%
Utilities & Communications	3.0%
Retailing	2.4%
Basic Materials	2.1%
Technology	2.1%
Special Products & Services	1.5%
Energy	1.0%
Leisure	1.0%
Autos & Housing (o)	0.0%
Fixed income sectors (i)	
High Yield Corporates	58.7%
Emerging Markets Bonds	3.3%
Floating Rate Loans	1.6%
Investment Grade Corporates	1.0%
Commercial Mortgage-Backed Securities	0.1%
Composition including fixed income credit quality (a)(i)	
BBB	1.2%
BB	19.6%
B	34.7%
CCC	8.5%
C (o)	0.0%
D	0.3%
Not Rated	0.4%
Non-Fixed Income	34.0%
Cash & Other	1.3%

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Portfolio Composition continued

- (a) For all securities other than those specifically described below, ratings are assigned to underlying securities utilizing ratings from Moody's, Fitch, and Standard & Poor's rating agencies and applying the following hierarchy: If all three agencies provide a rating, the middle rating (after dropping the highest and lowest ratings) is assigned; if two of the three agencies rate a security, the lower of the two is assigned. Ratings are shown in the S&P and Fitch scale (e.g., AAA). Securities rated BBB or higher are considered investment grade. All ratings are subject to change. Not Rated includes fixed income securities, including fixed income futures contracts, which have not been rated by any rating agency. Non-Fixed Income includes equity securities (including convertible bonds and equity derivatives) and commodities. The fund may not hold all of these instruments. The fund is not rated by these agencies.
- (i) For purposes of this presentation, the components include the value of securities, and reflect the impact of the equivalent exposure of derivative positions, if any. These amounts may be negative from time to time. Equivalent exposure is a calculated amount that translates the derivative position into a reasonable approximation of the amount of the underlying asset that the portfolio would have to hold at a given point in time to have the same price sensitivity that results from the portfolio's ownership of the derivative contract. When dealing with derivatives, equivalent exposure is a more representative measure of the potential impact of a position on portfolio performance than value. The bond component will include any accrued interest amounts.
- (o) Less than 0.1%.

Where the fund holds convertible bonds, these are treated as part of the equity portion of the portfolio.

Cash & Other can include cash, other assets less liabilities, offsets to derivative positions, and short-term securities.

Percentages are based on net assets as of 4/30/15.

The portfolio is actively managed and current holdings may be different.

Table of Contents**PORTFOLIO MANAGERS PROFILES**

Portfolio Manager	Primary Role	Since	Title and Five Year History
William Adams	Lower Quality Debt Instruments Portfolio Manager	2011	Investment Officer of MFS; employed in the investment management area of MFS since 2009.
Ward Brown	Emerging Markets Debt Instruments Portfolio Manager	2012	Investment Officer of MFS; employed in the investment management area of MFS since 2005.
Nevin Chitkara	Equity Securities Portfolio Manager	2012	Investment Officer of MFS; employed in the investment management area of MFS since 1997.
David Cole	Lower Quality Debt Instruments Portfolio Manager	2006	Investment Officer of MFS; employed in the investment management area of MFS since 2004.
Matthew Ryan	Emerging Markets Debt Instruments Portfolio Manager	2012	Investment Officer of MFS; employed in the investment management area of MFS since 1997.

OTHER NOTES

The fund's shares may trade at a discount or premium to net asset value. When fund shares trade at a premium, buyers pay more than the net asset value underlying fund shares, and shares purchased at a premium would receive less than the amount paid for them in the event of the fund's liquidation.

The fund's monthly distributions may include a return of capital to shareholders to the extent that the fund's net investment income and net capital gains are insufficient to meet the fund's target annual distribution rate. Distributions that are treated for federal income tax purposes as a return of capital will reduce each shareholder's basis in his or her shares and, to the extent the return of capital exceeds such basis, will be treated as gain to the shareholder from a sale of shares. It may also result in a recharacterization of what economically represents a return of capital to ordinary income in those situations where a fund has long term capital gains and a capital loss carryforward. Returns of shareholder capital have the effect of reducing the fund's assets and increasing the fund's expense ratio.

The fund's target annual distribution rate is calculated based on an annual rate of 10.00% of the fund's average monthly net asset value, not a fixed share price, and the fund's dividend amount will fluctuate with changes in the fund's average monthly net assets.

In accordance with Section 23(c) of the Investment Company Act of 1940, the fund hereby gives notice that it may from time to time repurchase shares of the fund in the open market at the option of the Board of Trustees and on such terms as the Trustees shall determine.

Table of Contents**PORTFOLIO OF INVESTMENTS**

4/30/15 (unaudited)

The Portfolio of Investments is a complete list of all securities owned by your fund. It is categorized by broad-based asset classes.

Bonds - 62.1%		
Issuer	Shares/Par	Value (\$)
Aerospace - 1.6%		
Aerojet Rocketdyne Holdings, Inc., 7.125%, 3/15/21	\$ 125,000	\$ 134,025
Bombardier, Inc., 7.75%, 3/15/20 (n)	55,000	58,154
Bombardier, Inc., 6.125%, 1/15/23 (n)	155,000	148,134
Bombardier, Inc., 7.5%, 3/15/25 (n)	55,000	54,519
CPI International, Inc., 8.75%, 2/15/18	190,000	195,344
Kratos Defense & Security Solutions, Inc., 7%, 5/15/19	45,000	40,050
TransDigm, Inc., 6%, 7/15/22	25,000	25,156
TransDigm, Inc., 6.5%, 7/15/24	110,000	111,634
		\$ 767,016
Apparel Manufacturers - 0.1%		
PVH Corp., 4.5%, 12/15/22	\$ 60,000	\$ 61,200
Asset-Backed & Securitized - 0.1%		
Citigroup Commercial Mortgage Trust, FRN, 5.899%, 12/10/49	\$ 220,000	\$ 29,106
Falcon Franchise Loan LLC, FRN, 23.05%, 1/05/25 (i)(z)	18,357	4,268
Morgan Stanley Capital I, Inc., FRN, 1.418%, 4/28/39 (i)(z)	150,883	760
		\$ 34,134
Automotive - 1.5%		
Accuride Corp., 9.5%, 8/01/18	\$ 150,000	\$ 155,625
Goodyear Tire & Rubber Co., 6.5%, 3/01/21	140,000	148,120
Goodyear Tire & Rubber Co., 7%, 5/15/22	40,000	43,800
Lear Corp., 4.75%, 1/15/23	80,000	81,200
Lear Corp., 5.25%, 1/15/25	65,000	66,381
Schaeffler Holding Finance B.V., 6.25%, 11/15/19 (n)(p)	200,000	213,000
		\$ 708,126
Broadcasting - 1.4%		
AMC Networks, Inc., 7.75%, 7/15/21	\$ 101,000	\$ 110,090
Clear Channel Communications, Inc., 9%, 3/01/21	152,000	145,730
Clear Channel Worldwide Holdings, Inc., A, 6.5%, 11/15/22	25,000	26,188
Clear Channel Worldwide Holdings, Inc., B, 6.5%, 11/15/22	85,000	89,888
Liberty Media Corp., 8.5%, 7/15/29	110,000	123,200
Liberty Media Corp., 8.25%, 2/01/30	35,000	38,763
Netflix, Inc., 5.375%, 2/01/21	70,000	73,150
Netflix, Inc., 5.875%, 2/15/25 (n)	30,000	31,950
Univision Communications, Inc., 5.125%, 2/15/25 (n)	35,000	35,263
		\$ 674,222

Table of Contents*Portfolio of Investments (unaudited) continued*

Issuer	Shares/Par	Value (\$)
Bonds - continued		
Brokerage & Asset Managers - 0.2%		
E*Trade Financial Corp., 4.625%, 9/15/23	\$ 70,000	\$ 71,488
Building - 1.8%		
Allegion U.S. Holding Co., Inc., 5.75%, 10/01/21	\$ 140,000	\$ 147,350
Building Materials Corp. of America, 5.375%, 11/15/24 (n)	75,000	76,875
Building Materials Holding Corp., 6.75%, 5/01/21 (n)	30,000	31,875
Gibraltar Industries, Inc., 6.25%, 2/01/21	30,000	30,450
HD Supply, Inc., 7.5%, 7/15/20	110,000	117,975
Headwaters, Inc., 7.25%, 1/15/19	70,000	73,325
Nortek, Inc., 8.5%, 4/15/21	150,000	162,000
Roofing Supply Group LLC/Roofing Supply Finance, Inc., 10%, 6/01/20 (n)	179,000	180,790
		\$ 820,640
Business Services - 0.5%		
Equinix, Inc., 4.875%, 4/01/20	\$ 55,000	\$ 56,788
Equinix, Inc., 5.375%, 1/01/22	25,000	25,938
Equinix, Inc., 5.375%, 4/01/23	35,000	36,138
Iron Mountain, Inc., REIT, 6%, 8/15/23	30,000	31,950
NeuStar, Inc., 4.5%, 1/15/23	110,000	96,800
		\$ 247,614
Cable TV - 3.6%		
Altice Financing S.A., 7.875%, 12/15/19 (n)	\$ 200,000	\$ 212,510
CCO Holdings LLC/CCO Holdings Capital Corp., 6.5%, 4/30/21	60,000	62,348
CCO Holdings LLC/CCO Holdings Capital Corp., 5.125%, 5/01/23 (n)	70,000	69,300
CCO Holdings LLC/CCO Holdings Capital Corp., 5.75%, 1/15/24	115,000	116,438
CCO Holdings LLC/CCO Holdings Capital Corp., 5.375%, 5/01/25 (n)	25,000	24,563
Cequel Communications Holdings, 6.375%, 9/15/20 (n)	115,000	121,181
DISH DBS Corp., 6.75%, 6/01/21	60,000	63,530
DISH DBS Corp., 5%, 3/15/23	90,000	85,275
DISH DBS Corp., 5.875%, 11/15/24	30,000	29,550
Intelsat Jackson Holdings S.A., 6.625%, 12/15/22	105,000	103,688
Intelsat Jackson Holdings S.A., 5.5%, 8/01/23	100,000	94,125
Intelsat Luxembourg S.A., 8.125%, 6/01/23	170,000	155,603
LGE Holdco VI B.V., 7.125%, 5/15/24 (n)	EUR 100,000	126,601
SIRIUS XM Radio, Inc., 4.25%, 5/15/20 (n)	\$ 10,000	9,950
SIRIUS XM Radio, Inc., 5.875%, 10/01/20 (n)	10,000	10,438
SIRIUS XM Radio, Inc., 4.625%, 5/15/23 (n)	85,000	82,450
SIRIUS XM Radio, Inc., 6%, 7/15/24 (n)	50,000	51,875
SIRIUS XM Radio, Inc., 5.375%, 4/15/25 (n)	45,000	45,225
Unitymedia KabelBW GmbH, 6.125%, 1/15/25 (n)	200,000	208,750
		\$ 1,673,400

Table of Contents*Portfolio of Investments (unaudited) continued*

Issuer	Shares/Par	Value (\$)
Bonds - continued		
Chemicals - 1.7%		
Celanese U.S. Holdings LLC, 5.875%, 6/15/21	\$ 63,000	\$ 69,143
Celanese U.S. Holdings LLC, 4.625%, 11/15/22	20,000	20,450
Evolution Escrow Issuer Co., 7.5%, 3/15/22 (n)	125,000	126,563
Hexion U.S. Finance Corp., 6.625%, 4/15/20	65,000	60,775
Hexion U.S. Finance Corp./Hexion Nova Scotia Finance, 8.875%, 2/01/18	140,000	124,775
INEOS Group Holdings S.A., 5.875%, 2/15/19 (n)	200,000	202,500
Tronox Finance LLC, 6.375%, 8/15/20	185,000	181,300
		\$ 785,506
Computer Software - 0.2%		
Syniverse Holdings, Inc., 9.125%, 1/15/19	\$ 40,000	\$ 37,600
VeriSign, Inc., 4.625%, 5/01/23	35,000	34,983
		\$ 72,583
Conglomerates - 1.6%		
Amsted Industries Co., 5%, 3/15/22 (n)	\$ 105,000	\$ 108,281
BC Mountain LLC, 7%, 2/01/21 (n)	95,000	90,013
EnerSys, 5%, 4/30/23 (n)	130,000	131,625
EnPro Industries, Inc., 5.875%, 9/15/22 (n)	100,000	104,500
Entegris, Inc., 6%, 4/01/22 (n)	165,000	172,425
Renaissance Acquisition, 6.875%, 8/15/21 (n)	145,000	134,850
		\$ 741,694
Construction - 0.2%		
Empresas ICA S.A.B. de C.V., 8.9%, 2/04/21	\$ 125,000	\$ 115,275
Consumer Products - 0.5%		
Prestige Brands, Inc., 8.125%, 2/01/20	\$ 30,000	\$ 32,250
Prestige Brands, Inc., 5.375%, 12/15/21 (n)	55,000	55,688
Spectrum Brands, Inc., 6.375%, 11/15/20	110,000	116,600
Spectrum Brands, Inc., 6.125%, 12/15/24 (n)	10,000	10,600
		\$ 215,138
Consumer Services - 1.8%		
ADT Corp., 6.25%, 10/15/21	\$ 165,000	\$ 177,375
Garda World Security Corp., 7.25%, 11/15/21 (n)	60,000	59,700
Garda World Security Corp., 7.25%, 11/15/21 (n)	30,000	29,850
Grupo Posadas S.A.B. de C.V., 7.875%, 11/30/17	150,000	149,625
Interval Acquisition Corp., 5.625%, 4/15/23 (z)	125,000	126,563
Monitronics International, Inc., 9.125%, 4/01/20	145,000	143,550
Sabre GLBL, Inc., 5.375%, 4/15/23 (n)	80,000	81,600
Service Corp. International, 5.375%, 5/15/24	50,000	53,125
		\$ 821,388

Table of Contents*Portfolio of Investments (unaudited) continued*

Issuer	Shares/Par	Value (\$)
Bonds - continued		
Containers - 2.3%		
Ardagh Packaging Finance PLC, 9.125%, 10/15/20 (n)	\$ 200,000	\$ 214,000
Ball Corp., 5%, 3/15/22	95,000	99,038
Berry Plastics Group, Inc., 9.75%, 1/15/21	20,000	21,950
Berry Plastics Group, Inc., 5.5%, 5/15/22	125,000	129,531
Crown American LLC, 4.5%, 1/15/23	85,000	85,425
Multi-Color Corp., 6.125%, 12/01/22 (n)	100,000	104,000
Reynolds Group, 5.75%, 10/15/20	50,000	52,250
Reynolds Group, 8.25%, 2/15/21	115,000	122,331
Sealed Air Corp., 4.875%, 12/01/22 (n)	80,000	82,200
Sealed Air Corp., 5.125%, 12/01/24 (n)	25,000	26,063
Signode Industrial Group, 6.375%, 5/01/22 (n)	115,000	115,000
		\$ 1,051,788
Electrical Equipment - 0.1%		
Avaya, Inc., 10.5%, 3/01/21 (n)	\$ 70,000	\$ 61,600
Electronics - 0.8%		
Advanced Micro Devices, Inc., 6.75%, 3/01/19	\$ 120,000	\$ 104,400
Advanced Micro Devices, Inc., 7.5%, 8/15/22	35,000	28,700
Advanced Micro Devices, Inc., 7%, 7/01/24	65,000	50,538
Micron Technology, Inc., 5.875%, 2/15/22	40,000	42,050
Micron Technology, Inc., 5.5%, 2/01/25 (n)	65,000	64,675
Sensata Technologies B.V., 5.625%, 11/01/24 (n)	40,000	42,700
Sensata Technologies B.V., 5%, 10/01/25 (n)	40,000	41,300
		\$ 374,363
Emerging Market Quasi-Sovereign - 0.1%		
NOVA Chemicals Corp., 5%, 5/01/25 (n)	\$ 38,000	\$ 40,043
Emerging Market Sovereign - 0.6%		
Republic of Ecuador, 10.5%, 3/24/20 (n)	\$ 200,000	\$ 216,000
Republic of Venezuela, 7%, 3/31/38	203,000	82,723
		\$ 298,723
Energy - Independent - 4.8%		
Afren PLC, 11.5%, 2/01/16 (a)(d)(n)	\$ 200,000	\$ 88,000
Afren PLC, 15%, 4/25/16	174,593	164,991
American Energy-Permian Basin LLC, 7.125%, 11/01/20 (n)	35,000	25,725
American Energy-Permian Basin LLC, 7.375%, 11/01/21 (n)	135,000	99,563
Baytex Energy Corp., 5.625%, 6/01/24 (n)	95,000	91,913
Bonanza Creek Energy, Inc., 6.75%, 4/15/21	30,000	30,525
Chaparral Energy, Inc., 7.625%, 11/15/22	115,000	92,000
Chesapeake Energy Corp., 5.75%, 3/15/23	100,000	97,750
Concho Resources, Inc., 5.5%, 4/01/23	40,000	40,550
EP Energy LLC, 6.875%, 5/01/19	35,000	36,085

Table of Contents*Portfolio of Investments (unaudited) continued*

Issuer	Shares/Par	Value (\$)
Bonds - continued		
Energy - Independent - continued		
EP Energy LLC, 9.375%, 5/01/20	\$ 110,000	\$ 117,700
EP Energy LLC, 7.75%, 9/01/22	150,000	157,500
Halcon Resources Corp., 8.875%, 5/15/21	130,000	101,530
Hilcorp Energy I/Hilcorp Finance Co., 8%, 2/15/20 (n)	40,000	41,400
Linn Energy LLC/Linn Energy Finance Corp., 8.625%, 4/15/20	15,000	13,659
Linn Energy LLC/Linn Energy Finance Corp., 7.75%, 2/01/21	160,000	137,600
Linn Energy LLC/Linn Energy Finance Corp., 6.5%, 9/15/21	45,000	36,675
MEG Energy Corp., 6.5%, 3/15/21 (n)	85,000	83,938
MEG Energy Corp., 7%, 3/31/24 (n)	75,000	73,890
Northern Blizzard Resources, Inc., 7.25%, 2/01/22 (n)	80,000	76,000
Oasis Petroleum, Inc., 6.875%, 3/15/22	90,000	91,575
QEP Resources, Inc., 5.25%, 5/01/23	60,000	60,151
Rosetta Resources, Inc., 5.625%, 5/01/21	130,000	130,163
RSP Permian, Inc., 6.625%, 10/01/22 (n)	80,000	83,040
Sanchez Energy Corp., 6.125%, 1/15/23	110,000	107,800
SM Energy Co., 6.5%, 11/15/21	120,000	124,800
SM Energy Co., 6.125%, 11/15/22 (n)	50,000	52,500
		\$ 2,257,023
Entertainment - 0.8%		
Activision Blizzard, Inc., 6.125%, 9/15/23 (n)	\$ 95,000	\$ 104,679
Cedar Fair LP, 5.25%, 3/15/21	105,000	108,938
Cedar Fair LP, 5.375%, 6/01/24 (n)	35,000	36,138
Cinemark USA, Inc., 5.125%, 12/15/22	50,000	51,685
Six Flags Entertainment Corp., 5.25%, 1/15/21 (n)	90,000	92,925
		\$ 394,365
Financial Institutions - 3.2%		
Aircastle Ltd., 5.125%, 3/15/21	\$ 40,000	\$ 41,948
Aircastle Ltd., 5.5%, 2/15/22	40,000	42,700
Aviation Capital Group, 4.625%, 1/31/18 (n)	55,000	57,589
Aviation Capital Group, 6.75%, 4/06/21 (n)	25,000	29,036
CIT Group, Inc., 5.25%, 3/15/18	40,000	41,460
CIT Group, Inc., 6.625%, 4/01/18 (n)	119,000	127,628
CIT Group, Inc., 5.5%, 2/15/19 (n)	148,000	154,845
CIT Group, Inc., 5%, 8/15/22	35,000	36,050
Credit Acceptance Co., 7.375%, 3/15/23 (n)	85,000	84,575
Icahn Enterprises LP, 6%, 8/01/20	55,000	57,830
Icahn Enterprises LP, 5.875%, 2/01/22	110,000	113,702
Nationstar Mortgage LLC/Capital Corp., 6.5%, 8/01/18	60,000	61,050
Nationstar Mortgage LLC/Capital Corp., 7.875%, 10/01/20	305,000	314,150
Navient Corp., 5.875%, 3/25/21	60,000	59,700
SLM Corp., 8%, 3/25/20	135,000	150,355
SLM Corp., 7.25%, 1/25/22	80,000	84,800

Table of Contents*Portfolio of Investments (unaudited) continued*

Issuer	Shares/Par	Value (\$)
Bonds - continued		
Financial Institutions - continued		
SLM Corp., 6.125%, 3/25/24	\$ 50,000	\$ 48,563
		\$ 1,505,981
Food & Beverages - 0.5%		
Darling Ingredients, Inc., 5.375%, 1/15/22	\$ 75,000	\$ 76,313
Sun Merger Sub, Inc., 5.875%, 8/01/21 (n)	130,000	136,500
		\$ 212,813
Forest & Paper Products - 0.2%		
Appvion, Inc., 9%, 6/01/20 (n)	\$ 70,000	\$ 45,850
Tembec Industries, Inc., 9%, 12/15/19 (n)	60,000	61,200
		\$ 107,050
Gaming & Lodging - 2.0%		
CCM Merger, Inc., 9.125%, 5/01/19 (n)	\$ 150,000	\$ 162,938
Chester Downs & Marina LLC, 9.25%, 2/01/20 (n)	45,000	34,425
Greektown Holdings LLC, 8.875%, 3/15/19 (n)	145,000	153,338
Hilton Worldwide Finance LLC/Hilton Worldwide Finance Corp., 5.625%, 10/15/21	120,000	126,600
Isle of Capri Casinos, Inc., 8.875%, 6/15/20	35,000	38,325
Isle of Capri Casinos, Inc., 5.875%, 3/15/21	85,000	87,763
Isle of Capri Casinos, Inc., 5.875%, 3/15/21 (n)	20,000	20,650
MGM Resorts International, 6.625%, 12/15/21	90,000	96,300
MGM Resorts International, 6%, 3/15/23		
	Repurchases of common stock	
	(1,809)	(1,809)
	Tax benefit from stock-based awards	
	292	292
	Payments of capital lease obligations	
	(369)	(369)
	Net cash provided by financing activities	
	5,493	5,493
	Effect of exchange rate changes on cash and cash equivalents	
	1,600	1,600
	Net increase in cash and cash equivalents	
	76,508	76,508
	Cash and cash equivalents, beginning of period	
	183,448	183,448

Cash and cash equivalents, end of
period

\$259,956 \$ \$ 259,956

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Consolidated Statement of Cash Flows	As Reported	Nine months ended July 1, 2006		Restated
		Revenue Adjustment (in thousands)	Other Adjustments	
Cash flows from operating activities:				
Net income (loss)	\$ 35,143	\$ (5,510)	\$ 192	\$ 29,825
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Stock-based compensation	29,273			29,273
Depreciation and amortization	24,809			24,809
In-process research and development	2,100			2,100
Other non-cash costs (credits), net	1,958	(970)		988
Changes in operating assets and liabilities, net of effects of acquisitions:				
Accounts receivable	637			637
Accounts payable and accrued expenses	(10,487)		558	(9,929)
Customer advances		6,480		6,480
Accrued compensation and benefits	(14,353)			(14,353)
Deferred revenue	21,679		(750)	20,929
Accrued income taxes, net of income tax receivable	(24,572)			(24,572)
Other current assets and prepaid expenses	4,411			4,411
Other noncurrent assets and liabilities	(17,135)			(17,135)
Net cash provided by operating activities	53,463			53,463
Cash flows from investing activities:				
Additions to property and equipment	(13,065)			(13,065)
Acquisitions of businesses, net of cash acquired	(75,084)			(75,084)
Net cash used by investing activities	(88,149)			(88,149)
Cash flows from financing activities:				
Proceeds from issuance of common stock	4,052			4,052
Payment of withholding taxes in connection with settlement of restricted stock units	(102)			(102)
Credit facility origination costs	(897)			(897)
Payments of capital lease obligations	(323)			(323)
Net cash provided by financing activities	2,730			2,730
Effect of exchange rate changes on cash and cash equivalents	1,426			1,426
Net decrease in cash and cash equivalents	(30,530)			(30,530)
Cash and cash equivalents, beginning of period	204,423			204,423
Cash and cash equivalents, end of period	\$ 173,893	\$	\$	\$ 173,893

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Consolidated Statement of Comprehensive Income	Three months ended June 30, 2007			
	As Reported	Revenue	Other	Restated
		Adjustment	Adjustments	
Comprehensive income (loss):				
Net income (loss)	\$ 87,228	\$ 3,670	\$ (10,433)	\$ 80,465
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment, net of tax of \$0	(441)	1,464	(237)	786
Change in unrealized gain on investment securities, net of tax of \$0				
Impact of release of valuation allowance on U.S. net deferred tax assets	(53)		903	850
Other comprehensive income (loss)	(494)	1,464	666	1,636
Comprehensive income	\$ 86,734	\$ 5,134	\$ (9,767)	\$ 82,101

Consolidated Statement of Comprehensive Income	Three months ended July 1, 2006			
	As Reported	Revenue	Other	Restated
		Adjustment	Adjustments	
Comprehensive income (loss):				
Net income (loss)	\$ 16,876	\$ (962)	\$	\$ 15,914
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment, net of tax of \$0	1,470	(484)		986
Change in unrealized gain on investment securities, net of tax of \$0	28			28
Other comprehensive income (loss)	1,498	(484)		1,014
Comprehensive income	\$ 18,374	\$ (1,446)	\$	\$ 16,928

Consolidated Statement of Comprehensive Income	Nine months ended June 30, 2007			
	As Reported	Revenue	Other	Restated
		Adjustment	Adjustments	
Comprehensive income (loss):				
Net income (loss)	\$ 119,780	\$ 3,670	\$ (10,433)	\$ 113,017
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment, net of tax of \$0	2,139	1,438	(237)	3,340

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Change in unrealized gain on investment securities, net of tax of \$0	(680)			(680)
Impact of release of valuation allowance on U.S. net deferred tax assets	(53)		903	850
Other comprehensive income	1,406	1,438	666	3,510
Comprehensive income	\$ 121,186	\$ 5,108	\$ (9,767)	\$ 116,527

Consolidated Statement of Comprehensive Income	Nine months ended July 1, 2006			Restated
	As Reported	Revenue Adjustment	Other Adjustments	
		(in thousands)		
Comprehensive income (loss):				
Net income (loss)	\$ 35,143	\$ (5,510)	\$ 192	\$ 29,825
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment, net of tax of \$0	1,044	793		1,837
Change in unrealized gain on investment securities, net of tax of \$0	(205)			(205)
Other comprehensive income	839	793		1,632
Comprehensive income	\$ 35,982	\$ (4,717)	\$ 192	\$ 31,457

Our equity incentive plans provide for grants of nonqualified and incentive stock options, common stock, restricted stock, restricted stock units and stock appreciation rights to employees, directors, officers and consultants. Until July 2005, we generally granted stock options. For those options, the option exercise price was typically the fair market

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value of our common stock at the date of grant and they generally vested over four years and expired ten years from the date of grant. Since our adoption of SFAS 123(R), we have awarded restricted stock and restricted stock units as the principal equity incentive awards, including performance-based awards that are earned based on achievement of performance criteria established by the Compensation Committee of our Board of Directors on or prior to the grant date. Each restricted stock unit represents the contingent right to receive one share of our common stock. Our equity incentive 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, 2006. We made the following restricted stock and restricted stock unit grants in the third quarter and first nine months of 2007 and 2006:

Grant Period	Restricted Stock		Restricted Stock Units	
	Performance-based (Number of Shares)	Time-based	Performance-based	Time-based (Number of Units)
Third quarter of 2007				420,740
First nine months of 2007	495,768	442,590	60,561	1,148,922
Third quarter of 2006			2,991	5,351
First nine months of 2006	515,617	434,800	338,858	1,297,629

Restricted Stock

Performance-based awards. In the first nine months of 2007 and 2006, we granted to our executive officers performance-based shares that are earned based on achievement of certain Company operating performance criteria specified by the Compensation Committee on or prior to the date of grant. With respect to the 2007 grants, in the third quarter of 2007, we reversed all compensation expense that we had recorded during the first six months of 2007 as we do not currently expect that these performance-based shares will be earned. With respect to the 2006 grants, because the specified performance criteria were achieved in full, the restrictions on 284,417 of the shares lapsed on November 9, 2006 and the restrictions on the remaining shares will lapse in equal installments on November 9, 2007 and 2008, provided that the holder of the award remains employed by us at those dates.

Time-based awards. In the second quarter of 2007, we granted 366,800 and 75,790 shares to our executive officers and members of our Board of Directors, respectively. The restrictions on the executive shares will lapse in substantially equal installments on February 15, 2008, 2009 and 2010, provided that the holder of the award remains employed by us at those dates. The restrictions on the shares granted to our directors will lapse in substantially equal installments on March 7, 2008, 2009 and 2010, provided that the holder of the award remains a director at those dates. In the first quarter of 2006, we granted 346,800 shares to our executive officers. The restrictions on one-third of these shares lapsed on November 9, 2006 and those on the remaining shares will lapse in substantially equal installments on November 9, 2007 and 2008, provided that the holder of the award remains employed by us at those dates. In the second quarter of 2006, we issued 88,000 shares of restricted stock to our non-employee directors, of which the restrictions on one-third of the shares lapsed on February 15, 2007 and the restrictions on the remaining shares will lapse in substantially equal installments on each of February 15, 2008 and 2009, provided that the holder of the award remains a director at those dates.

Restricted Stock Units

Performance-based awards. In the first nine months of 2007, we granted 60,561 performance-based restricted stock units to employees in connection with our employee management incentive plans for the 2007 fiscal year. These shares will vest on the later of November 9, 2007 or the date the Compensation Committee determines the extent to which the performance criteria have been achieved, provided that the holder of the award remains employed by us at that date. In the third quarter of 2007, we reversed all compensation expense related to these restricted stock units that we had recorded during the first six months of 2007 as we do not currently expect that these performance-based restricted stock units will be earned. In the first nine months of 2006, we granted 338,858 performance-based restricted stock units to employees in connection with our employee management incentive plans for the 2006 fiscal year, which were earned in full on November 9, 2006 based on achievement of specified performance criteria established by the Compensation Committee.

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Time-based awards. In the third quarter and first nine months of 2007, we granted 420,740 and 1,148,922 restricted stock units, respectively, to employees. The restricted stock units granted in the third quarter of 2007 will vest in three substantially equal installments on each of March 15, 2008, 2009 and 2010, provided that the holder of the award remains employed by us at those dates. The remaining 2007 awards will vest in substantially equal installments on each of the first three anniversaries of the date of grant, provided that the holder of the award remains employed by us at those dates. In the third quarter and first nine months of 2006, we granted 5,351 and 1,297,629 restricted stock units, respectively, to employees, which vest in three substantially equal installments on each of the first three anniversaries of the date of grant, provided that the holder of the award remains employed by us at those dates. With respect to all types of equity awards, in the first nine months of 2007, the restrictions on 664,463 restricted shares lapsed and 1,101,133 restricted stock units vested. The fair value of restricted shares and restricted stock units granted in the first nine months of 2007 was based on the fair market value of our common stock on the date of grant. The weighted average fair value per share of restricted shares and restricted stock units granted in the first nine months of 2007 was \$18.55.

Stock-based compensation expense amounts presented below reflect the reversal in the third quarter of 2007 of \$3.0 million recorded in the first six months of 2007 related to performance-based awards in connection with our executive and employee management incentive plans for the 2007 fiscal year. These performance-based awards would be earned based on achievement of operating performance targets which we currently do not believe will be met. The following table shows the classification of compensation expense recorded for our stock-based awards as reflected in our consolidated statements of operations:

	Three months ended		Nine months ended	
	June	July 1,	June	July 1,
	30,	2006	30,	2006
	2007			
	(in thousands)			
Cost of license revenue	\$ 60	\$ 29	\$ 100	\$ 96
Cost of service revenue	993	1,969	4,671	5,830
Sales and marketing	2,035	2,547	5,926	7,241
Research and development	1,058	2,336	4,529	6,653
General and administrative	884	3,188	7,281	9,453
Total stock-based compensation expense	\$ 5,030	\$ 10,069	\$ 22,507	\$ 29,273

5. Common Stock and Earnings Per Share (EPS)*Earnings Per Share*

Basic EPS is calculated by dividing net income by the weighted average number of shares outstanding during the period. Unvested restricted shares, although legally issued and outstanding, are not considered outstanding for purposes of calculating basic earnings per share. Diluted EPS is calculated by dividing net income by the weighted average number of shares outstanding plus the dilutive effect, if any, of outstanding stock options, restricted shares and restricted stock units using the treasury stock method. The calculation of the dilutive effect of outstanding equity awards under the treasury stock method includes consideration of unrecognized compensation expense and any tax benefits as additional proceeds.

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The following table presents the calculation for both basic and diluted EPS:

	Three months ended		Nine months ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
	Restated Note 2	Restated Note 2	Restated Note 2	Restated Note 2
	(in thousands, except per share data)			
Net income	\$ 80,465	\$ 15,914	\$ 113,017	\$ 29,825
Weighted average shares outstanding Basic	113,154	109,947	112,610	109,672
Dilutive effect of employee stock options, restricted shares and restricted stock units	4,346	2,924	4,813	3,258
Weighted average shares outstanding Diluted	117,500	112,871	117,423	112,930
Earnings per share Basic	\$ 0.71	\$ 0.14	\$ 1.00	\$ 0.27
Earnings per share Diluted	\$ 0.68	\$ 0.14	\$ 0.96	\$ 0.26

Stock options to purchase 3.5 million shares for both the third quarter and first nine months of 2007 and 5.5 million and 4.4 million shares for the third quarter and first nine months of 2006, respectively, were outstanding but were not included in the calculation of diluted earnings per share because the exercise prices per share, plus the per share tax benefits and unamortized compensation relating thereto, 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.

Share Repurchase Authorization

In September 1998, our Board of Directors authorized the repurchase of up to 8.0 million shares of our common stock and in July 2000 increased the shares authorized for repurchase to 16.0 million. We had repurchased 12.5 million shares through the end of 2004 and did not repurchase any additional shares until the third quarter of 2007, when our Board of Directors authorized us to resume repurchases within established parameters (described in Part II, Item 2 of this report). In the third quarter of 2007, we repurchased 100,000 shares for \$1.8 million. Through the end of the third quarter of 2007, we had repurchased, at a cost of \$368.6 million, a total of 12.6 million shares of the 16.0 million shares authorized for repurchase. In the fourth quarter of 2007 to date, we have repurchased an additional 457,000 shares for \$8.2 million.

6. Acquisitions*NC Graphics*

In the third quarter of 2007, we acquired NC Graphics (Cambridge) Limited, headquartered in England, for \$7.2 million in cash, including \$0.2 million of acquisition-related transaction costs. NC Graphics provided computer-aided manufacturing solutions for design and machining of molds, dies, prototypes, and other high-speed precision machining applications. Results of operations for NC Graphics have been included in the accompanying consolidated statements of operations since May 3, 2007. Our results of operations prior to this acquisition if presented on a pro forma basis, as if the companies had been combined since the beginning of fiscal 2006, would not differ materially from our reported results.

This acquisition was accounted for as a business combination. The purchase price allocation is preliminary pending the final valuation of the acquired assets and liabilities. The preliminary purchase price allocation resulted in goodwill of \$1.5 million; intangible assets of \$5.8 million (including purchased software of \$4.3 million, customer relationships of \$1.4 million, and other intangible assets of \$0.1 million, which are being amortized over useful lives ranging from 1 to 9 years); other net assets of \$0.8 million; and deferred tax liabilities of \$1.4 million. In addition, the preliminary purchase price allocation resulted in a charge of \$0.5 million for in-process research and development.

ITEDO

In the first quarter of 2007, we acquired ITEDO Software GmbH and ITEDO Software LLC (together, ITEDO), headquartered in Germany, for \$16.7 million in cash, including \$0.2 million of acquisition-related costs. In addition,

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we agreed to pay up to \$0.5 million of additional cash consideration if specified product integration targets are achieved within three years of the acquisition date of which \$0.3 million was paid in the third quarter of 2007. ITEDO provided software solutions for creating and maintaining technical illustrations to customers in multiple discrete manufacturing vertical markets such as automotive, aerospace and defense, and industrial equipment. ITEDO had approximately 30 employees and generated revenue of approximately \$5 million for the twelve months ended July 31, 2006. Results of operations for ITEDO have been included in the accompanying consolidated statements of operations since October 19, 2006. Our results of operations prior to this acquisition if presented on a pro forma basis, as if the companies had been combined since the beginning of fiscal 2006, would not differ materially from our reported results.

This acquisition was accounted for as a business combination. The purchase price allocation resulted in goodwill of \$11.5 million; intangible assets of \$8.1 million (including purchased software of \$6.2 million, customer relationships of \$1.8 million, and other intangible assets of \$0.1 million, which are being amortized over useful lives ranging from 4 to 10 years); other net liabilities of \$1.0 million; restructuring accruals of \$0.3 million related to our planned integration of ITEDO; deferred tax liabilities of \$2.5 million, equal to the tax effect of the amount of the acquired intangible assets other than goodwill that are not deductible for income tax purposes; and, as a result of recording those deferred tax liabilities, a \$1.2 million reduction in our valuation allowance recorded against our pre-acquisition deferred tax assets in the U.S. and a foreign jurisdiction. The goodwill and certain intangible assets are not deductible for tax purposes.

This transaction resulted in \$11.5 million of purchase price that exceeded the estimated fair values of tangible and intangible assets and liabilities, all of which was allocated to goodwill. We believe that the high amount of goodwill relative to identifiable intangible assets was the result of several factors including the potential to sell ITEDO products into our traditional manufacturing customer base, including leveraging our direct and indirect sales force and our established presence in geographies not previously served by ITEDO; and our intention to integrate our ITEDO, Arbortext, Windchill and Pro/ENGINEER solutions to enhance our technical publications capabilities.

Mathsoft

In the third quarter of 2006, we acquired Mathsoft Corporate Holdings, Inc., including its wholly owned subsidiary Mathsoft Engineering & Education, Inc. (together, Mathsoft). Mathsoft's primary product was Mathcad® software, which helps engineering organizations create, automate, document and reuse engineering calculations in the product development process, and in other mathematics-driven processes. Mathsoft had approximately 120 employees in offices primarily in the U.S. and Europe and generated revenue of approximately \$20 million for the twelve months ended March 31, 2006. Results of operations for Mathsoft have been included in the accompanying consolidated statement of operations since April 29, 2006. Our results of operations prior to this acquisition if presented on a pro forma basis, as if the companies had been combined since the beginning of fiscal 2006, would not differ materially from our reported results.

DENC and Cadtrain

In the first quarter of 2006, we acquired DENC AG and substantially all of the assets of Cadtrain, Inc. for an aggregate of \$9.9 million in cash. In addition, we agreed to pay up to an aggregate of \$2.0 million of additional cash consideration if specified targets, including revenue and customer retention results, were achieved within one year of the acquisition dates. As of September 30, 2006, the specified targets of the DENC contingent purchase price arrangement were met and related payments of \$0.5 million were recorded as additional goodwill. In the first quarter of 2007, the specified targets of the Cadtrain contingent purchase price arrangement were met and related payments of \$1.5 million were recorded as additional goodwill.

7. Goodwill and Acquired Intangible Assets

We have two reportable segments: (1) software products and (2) services. As of June 30, 2007 and September 30, 2006, goodwill and acquired intangible assets in the aggregate attributable to our software products reportable segment was \$301.9 million and \$300.9 million, respectively; and attributable to our services reportable segment was \$25.5 million and \$26.2 million, respectively. Goodwill and other 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,

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reduce the fair value of the reporting segment below its carrying value. We completed our annual impairment review as of June 30, 2007 and concluded that no impairment charge was required as of that date.

Goodwill and acquired intangible assets consisted of the following:

	June 30, 2007			September 30, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value (in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Goodwill and intangible assets with indefinite lives (not amortized):						
Goodwill			\$ 245,733			\$ 249,252
Trademarks			4,271			4,200
			250,004			253,452
Intangible assets with finite lives (amortized):						
Purchased software	\$ 67,312	\$ 40,573	26,739	\$ 56,096	\$ 35,098	20,998
Capitalized software	22,877	22,769	108	22,877	22,252	625
Customer lists and relationships	68,239	19,933	48,306	64,634	15,195	49,439
Trademarks and tradenames	1,758	602	1,156	1,645	313	1,332
Other	2,041	989	1,052	1,910	634	1,276
	\$ 162,227	\$ 84,866	77,361	\$ 147,162	\$ 73,492	73,670
Total goodwill and acquired intangible assets			\$ 327,365			\$ 327,122

The changes in the carrying amounts of goodwill and intangible assets with indefinite lives at June 30, 2007 from September 30, 2006 are due to the impact of acquisitions (see Note 6), the \$20.0 million decrease in goodwill resulting from our reversal of the valuation allowance on U.S. net deferred tax assets (see Note 10), and to foreign currency translation adjustments related to those asset balances that are recorded in non-U.S. currencies.

Changes in goodwill, presented by reportable segment, were as follows:

	Software Products Segment	Services Segment (in thousands)	Total
Balance, September 30, 2006	\$ 231,699	\$ 17,553	\$ 249,252
Acquisition of NC Graphics	1,542		1,542
Acquisition of ITEDO	11,442		11,442
Additional purchase price paid for Cadtrain acquisition		1,500	1,500
Reversal of valuation allowance against U.S. net deferred tax assets	(18,552)	(1,419)	(19,971)

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Foreign currency translation adjustments	1,850	118	1,968
Balance, June 30, 2007	\$ 227,981	\$ 17,752	\$ 245,733

The aggregate amortization expense for intangible assets with finite lives was classified in our consolidated statements of operations as follows:

	Three months ended		Nine months ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
	(in thousands)			
Amortization of acquired intangible assets	\$ 1,764	\$ 1,646	\$ 5,440	\$ 4,292
Cost of license revenue	1,774	1,529	5,411	3,920
Cost of service revenue	17	65	66	169
Total amortization expense	\$ 3,555	\$ 3,240	\$ 10,917	\$ 8,381

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In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure relative to uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006, with early adoption encouraged. We will adopt FIN 48 at the beginning of fiscal 2008. We are currently evaluating whether or not the adoption of FIN 48 will have a material effect on our consolidated financial position, results of operations or cash flows.

Fair Value Measurements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not believe the adoption of SFAS 157 in fiscal 2009 will have a material effect on our consolidated financial position, results of operations or cash flows.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS 159). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This Statement is effective as of the beginning of fiscal 2009, with early adoption permitted. We do not believe the adoption of SFAS 159 will have a material effect on our consolidated financial position, results of operations or cash flows.

9. Segment Information

We operate within a single industry segment – computer software and related services. Operating segments as defined by FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), are 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 and reportable segments: (1) Software Products, which includes license and maintenance revenue (including new releases and technical support); and (2) Services, which includes consulting, implementation, training and other support revenue. 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.

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We report our revenue in two product categories:

Enterprise Solutions, which includes Windchill®, Pro/INTRALINK®, ProductView , Arbortext® Publishing Engine , Arbortext IsoView® and all other solutions that help companies collaborate and manage and publish information across an extended enterprise; and

Desktop Solutions, which includes Pro/ENGINEER®, Arbortext Editor , Arbortext IsoDraw®, Mathcad® and all other solutions that help companies create content and improve desktop productivity.

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

	Three months ended		Nine months ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
	Restated	Restated	Restated	Restated
	Note 2	Note 2	Note 2	Note 2
	(in thousands)			
Revenue:				
Software Products segment:				
License:				
Desktop solutions	\$ 38,240	\$ 43,547	\$ 130,268	\$ 114,270
Enterprise solutions	23,858	22,164	69,754	64,593
Total software products license revenue	62,098	65,711	200,022	178,863
Maintenance: (1)				
Desktop solutions	82,550	76,569	243,455	222,052
Enterprise solutions	20,534	17,547	58,979	49,913
Total software products maintenance revenue	103,084	94,116	302,434	271,965
Total software products revenue	165,182	159,827	502,456	450,828
Services segment:				
Desktop solutions	18,165	22,875	55,788	60,458
Enterprise solutions	41,517	32,863	116,383	92,400
Total service revenue	59,682	55,738	172,171	152,858
Total revenue:				
Desktop solutions	138,955	142,991	429,511	396,780
Enterprise solutions	85,909	72,574	245,116	206,906
Total revenue	\$ 224,864	\$ 215,565	\$ 674,627	\$ 603,686
Operating income (loss): (2)(3)				
Software Products segment	\$ 104,117	\$ 99,517	\$ 321,348	\$ 283,513
Services segment	6,884	4,234	12,650	7,307
Sales and marketing expenses	(74,573)	(73,708)	(215,694)	(201,892)
General and administrative expenses	(16,855)	(17,721)	(56,489)	(55,389)

Total operating income	\$ 19,573	\$ 12,322	\$ 61,815	\$ 33,539
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(1) Maintenance revenue is included in Service Revenue in our consolidated statements of operations.

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

(3) As described in Note 3, for the three months and nine months ended July 1, 2006, we recorded a net restructuring charge of \$5.9 million. For the three months and nine months ended July 1, 2006, Software Products included

\$1.5 million,
Services
included
\$1.1 million,
sales and
marketing
included
\$3.6 million,
and general and
administrative
expenses
included \$(0.3)
million of the
restructuring
charge recorded
in those periods.

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

	Three months ended		Nine months ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
	Restated Note 2	Restated Note 2	Restated Note 2	Restated Note 2
	(in thousands)			
Revenue:				
North America (1)	\$ 86,884	\$ 90,955	\$ 262,774	\$ 244,875
Europe (2)	86,166	71,973	251,757	213,753
Asia-Pacific (3)	51,814	52,637	160,096	145,058
Total revenue	\$ 224,864	\$ 215,565	\$ 674,627	\$ 603,686

(1) Includes revenue in the United States totaling \$82.7 million and \$87.0 million for the three months ended June 30, 2007 and July 1, 2006, respectively, and \$249.5 million and \$233.2 million for the nine months ended June 30, 2007 and July 1, 2006, respectively.

(2) Includes revenue in Germany totaling \$26.4 million and \$21.5 million for the three months ended June 30, 2007

and July 1,
2006,
respectively,
and
\$76.6 million
and
\$63.4 million
for the nine
months ended
June 30, 2007
and July 1,
2006,
respectively.

- (3) Includes
revenue in
Japan totaling
\$19.2 million
and
\$22.7 million
for the three
months ended
June 30, 2007
and July 1,
2006,
respectively,
and
\$68.8 million
and
\$64.5 million
for the nine
months ended
June 30, 2007
and July 1,
2006,
respectively.

Total long-lived tangible assets by geographic region have not changed significantly since September 30, 2006.

10. Income Taxes

Our income tax provisions for the three and nine months ended June 30, 2007 include a tax benefit of \$58.9 million recorded upon our decision in the third quarter of 2007 to release a substantial portion of the valuation allowance recorded against net deferred tax assets in the U.S. and a foreign jurisdiction as well as a tax benefit of \$3.9 million recorded in the third quarter of 2007 upon the favorable outcome of a tax refund claim in the U.S. Our income tax provisions for the three and nine months ended June 30, 2006 include a tax benefit of \$6.1 million recorded upon the favorable resolution of a tax audit in the U.S., in connection with which we made federal income tax payments of \$9.5 million for liabilities arising from our income tax returns for fiscal years 2001 and 2002. As a result of the tax payments made being less than the accrued income taxes that we had recorded for those years, we recorded an income tax benefit in the third quarter of 2006 of \$6.1 million. Excluding the effect of these one-time tax benefits, our income tax provisions in the three and nine months ended June 30, 2007 and 2006 consisted primarily of taxes owed in relation to the income generated by our foreign subsidiaries as well as withholding taxes that we incurred in the U.S. in connection with certain foreign operations. The tax provisions of those periods included only insignificant amounts in relation to the income that we generated in the U.S., due to our utilization of available net operating loss

carryforwards that previously had been recorded in our balance sheet with a full valuation allowance. As of the end of the second quarter of 2007, a full valuation allowance was recorded against our net deferred tax assets (consisting primarily of operating loss carryforwards) in the U.S. and certain foreign jurisdictions. Based upon our operating results over recent years and through June 30, 2007 as well as an assessment of our expected future results of operations, during the third quarter of 2007, we determined that it had become more likely than not that we will realize a substantial portion of our deferred tax assets in the U.S. and a foreign jurisdiction. As a result, during the third quarter, we released a total of \$79.8 million of our valuation allowances. Of the \$79.8 million valuation allowance release, \$58.9 million was recorded as a one-time income tax benefit, \$20.0 million was recorded as a reduction to goodwill recorded upon prior acquisitions, and \$0.9 million was recorded as a decrease to accumulated other comprehensive loss within stockholders' equity.

Table of Contents**11. Commitments and Contingencies***Revolving Credit Agreement*

We have a \$230 million multi-currency bank revolving credit facility with a syndicate of seven banks. The credit facility was established primarily for general corporate purposes, including acquisitions of businesses, and may be increased by up to an additional \$150 million if the existing or additional lenders are willing to make such increased commitments. The credit facility expires on February 20, 2011, when all amounts will be due and payable in full. Any obligations under the credit facility are guaranteed by PTC's material domestic subsidiaries and are collateralized by a pledge of 65% of the capital stock of PTC's material first-tier non-U.S. subsidiaries. We have not borrowed any funds under the credit facility to date.

Interest rates on outstanding borrowings under the credit facility would range from 0.75% to 1.50% above the Eurodollar rate for Eurodollar-based borrowings or would be at the defined base rate for base rate borrowings, in each case based upon our leverage ratio. In addition, we may borrow certain foreign currencies at the London interbank-offered interest rates for those currencies, with the same range above such rates based on our leverage ratio. A quarterly commitment fee based on the undrawn portion of the credit facility is required to be paid by us, ranging from 0.125% to 0.30% per year, depending upon our leverage ratio.

The credit facility limits our and our subsidiaries' ability to, among other things: incur additional indebtedness; incur liens or guarantee obligations; pay dividends and make other distributions; make investments and enter into joint ventures; dispose of assets; and engage in transactions with affiliates, except on an arms-length basis. Under the credit facility, we and our material domestic subsidiaries may not invest cash or property in, or loan cash to, our foreign subsidiaries in aggregate amounts exceeding \$25 million for any purpose and an additional \$50 million for acquisitions of businesses. In addition, under the credit facility, we and our subsidiaries must maintain specified leverage and fixed-charge ratios. Any failure to comply with the financial or operating covenants of the credit facility would not only prevent us from being able to borrow additional funds, but would also constitute a default, resulting in, among other things, the amounts outstanding, including all accrued interest and unpaid fees, becoming immediately due and payable. A change in control of PTC (as defined in the credit facility) also constitutes an event of default, permitting the lenders to accelerate the required payments of all amounts due and to terminate the credit facility. We were in compliance with all financial and operating covenants of the credit facility as of June 30, 2007.

Legal Proceedings

On August 2, 2007, GE Capital Leasing Corporation (GELC) filed a lawsuit against PTC in the U.S. District Court for the District of Massachusetts. The lawsuit alleges that an employee of Toshiba Corporation fraudulently induced GELC to provide over \$60 million in financing for purchases of third party products, including PTC software, during the period from 2003 to 2006. GELC claims that PTC participated in the alleged scheme or, alternatively, should have been aware of the scheme and made negligent misrepresentations that enabled the scheme to continue undetected. All of the alleged transactions occurred in Japan. GELC claims damages of \$47 million and seeks three times that amount plus attorneys' fees. We believe GELC's claims against PTC are without merit and intend to contest them vigorously. 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.

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 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

Restatement of Previously Issued Financial Results

As a result of an independent investigation led by the Audit Committee of our Board of Directors, the Audit Committee concluded on October 29, 2007 that we would need to restate our previously issued financial statements for the effect of certain transactions involving Toshiba Corporation of Japan (Toshiba), for which we recorded revenue of approximately \$41 million during fiscal 2001 through 2006. Based on its investigation, the Audit Committee concluded that the understanding of the arrangement was not fully reflected in the order paperwork for these transactions because there were additional circumstances known or knowable by one or more of our personnel in Japan. That condition required us to change our conclusion that the transactions met the revenue recognition criteria of Statement of Position 97-2, *Software Revenue Recognition*.

The results of the investigation indicate that during the period 2001 to 2006, an employee of Toshiba Corporation initiated purchases of both software and services from our subsidiary in Japan, PTC Japan K.K. (PTC Japan). Many of these purchases were completed through a third party trading company that procured the software and services on Toshiba's behalf. The transactions were supported by orders that were signed by employees of Toshiba and the third party trading company. PTC Japan delivered the items for which revenue was recorded and was paid for the orders in question. The Toshiba employee also allegedly entered into a series of financing agreements with third party leasing companies, including GE Capital Leasing Corporation of Japan (GECL), in the name of Toshiba to fund various purchases. As part of those transactions, the leasing companies allegedly entered into transactions with various third party trading companies to procure the purchased items on behalf of Toshiba. We were not a party to those financing agreements. Toshiba has disclaimed responsibility for repayment of these financed amounts and has alleged that the Toshiba employee who entered into the financing agreements was not authorized to do so and that Toshiba did not receive delivery of the items so financed.

Recently, the Toshiba employee involved in the transactions was arrested and charged with defrauding certain of the leasing companies. Among the allegations against him are that he forged contracts in the name of Toshiba. In addition, three individuals each employed by a different trading company involved in the transactions have been arrested for alleged involvement in a scheme to defraud the leasing companies. According to published news reports, the Toshiba employee and these other individuals are suspected of diverting some of the proceeds of the financings to a bank account controlled by one or more of them. Following these arrests, it was reported on October 23, 2007 that two former employees of PTC Japan were arrested on suspicion of demanding hush money from one of the participants in the fraudulent scheme. The press accounts indicate that the former PTC Japan employees who left employment with PTC Japan in 2003 and 2004, respectively were no longer working at PTC Japan at the time of the alleged demands. According to the press accounts, these individuals have not been charged with participating in the alleged underlying fraud.

To effect the restatement of revenue associated with the transactions placed by the Toshiba employee, we reduced previously recorded revenue by approximately \$8 million in fiscal 2006, \$15 million in fiscal 2005, \$9 million in fiscal 2004, \$2 million in fiscal 2003 and \$7 million in prior years, and recorded related income tax effects. We did not make any adjustments to the costs incurred in connection with these transactions due to the uncertainty regarding our ultimate ability to retain the advances received for these transactions and our belief that all such costs are

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unrecoverable. Upon restatement, the revenue reversed from those prior periods was deferred and classified as Customer Advances in our consolidated balance sheets. That liability (which totaled \$38.0 million and \$39.5 million at June 30, 2007 and September 30, 2006, respectively, after the effects of foreign currency movements) will remain recorded until the rights and obligations of the several companies connected with the Toshiba transactions are resolved. To the extent that matters are resolved in our favor, we will reduce Customer Advances and record revenue or other income at that time.

Our restatement of prior period financial statements also includes adjustments for other previously identified errors that we had corrected in the periods they became known to us rather than in the periods in which they originated because we believed that the amounts of such errors, individually and in the aggregate, were not material to our financial statements for the affected periods. In this restatement, we have now recorded those corrections in the periods in which each error originated. Such adjustments, which have been tax effected, primarily relate to (i) recording rent expense on a straight-line basis for one of our office facilities, (ii) recording stock-based compensation expense due to the timing of approvals for certain stock options we granted, (iii) deferring or reversing revenue for certain customer orders in the Asia-Pacific region, and (iv) reversing an income tax reserve that was unwarranted when established. Our restatement also includes an adjustment to correct our third quarter 2007 financial statements for a \$10.4 million overstatement of reported net income, which resulted from tax errors detected in the fourth quarter of 2007 relating primarily to our release in the third quarter of a substantial portion of the valuation allowance for our U.S. net deferred tax assets.

Summary of the Restatement Effects

A summary of the cumulative revenue and net income effects of the restatement on our consolidated financial statements is as follows:

	Nine months ended June 30,		Year ended September 30,			Prior Years	Total
	2007	2006	2005	2004	2003		
	(in thousands, except per share data)						
Revenue, as previously reported	\$ 674,859	\$ 854,918	\$ 720,719	\$ 660,029	\$ 671,940		
Adjustments	(232)	(6,935)	(12,744)	(8,361)	(2,487)	\$ (10,506)	\$ (41,265)
Revenue, as restated	\$ 674,627	\$ 847,983	\$ 707,975	\$ 651,668	\$ 669,453		
Net income (loss), as previously reported	\$ 119,780	\$ 60,866	\$ 83,592	\$ 34,813	\$ (98,280)		
Adjustments	(6,763)	(4,062)	(10,405)	(3,228)	(2,907)	\$ (12,927)	\$ (40,292)
Net income (loss), as restated	\$ 113,017	\$ 56,804	\$ 73,187	\$ 31,585	\$ (101,187)		
Earnings (loss) per share Diluted, as previously reported	\$ 1.02	\$ 0.54	\$ 0.75	\$ 0.32	\$ (0.93)		
Adjustments	(0.06)	(0.04)	(0.10)	(0.03)	(0.03)		

Earnings (loss) per share Diluted, as restated	\$ 0.96	\$ 0.50	\$ 0.65	\$ 0.29	\$ (0.96)
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The restatement had no effect on previously reported cash balances or on the amounts of net cash flows from operating, investing and financing activities. The adjustments made as a result of the restatement are more fully described in Note 2 to our consolidated financial statements included in Part I, Item 1 Unaudited Financial Statements of this Form 10-Q/A. Our assessment of the effectiveness of our disclosure controls and procedures is included in Part I, Item 4 Controls and Procedures of this Form 10-Q/A.

Disclosure Amended by this Form 10-Q/A

All amounts referenced to June 30, 2007, September 30, 2006 and July 1, 2006 in the following discussion reflect the balances and amounts on a restated basis. Also, comparisons of the three and nine months ended June 30, 2007 and July 1, 2006 to any other periods have been revised from those included in our Original Form 10-Q as necessary to reflect the restated information.

This Form 10-Q/A modifies only the disclosures described in the preceding paragraph to reflect the restatement and does not modify or update such disclosures in any other respect, or any other disclosures presented in the Original Form 10-Q. Further, this Form 10-Q/A does not reflect any other events occurring after August 9, 2007, the date we filed the Original Form 10-Q. We specifically note that we have not updated any forward-looking statements or our Risk Factors to reflect events occurring after the date we filed the Original Form 10-Q. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the SEC since the filing date of the Original Form 10-Q, including our Current Reports on Form 8-K, our Annual Report on Form 10-K for the year ended September 30, 2007, and the amendments to our Quarterly Reports on Form 10-Q for the quarterly periods ended December 30, 2006 and March 31, 2007.

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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 subject to the inherent uncertainties in predicting future results and conditions. Risks and uncertainties that could cause actual results to differ materially from those projected include the following: we may be unable to increase revenues or successfully execute strategic and other business initiatives while containing expenses; our efforts to globalize our workforce will cause us to incur additional restructuring charges and could disrupt our business operations; we may be unable to successfully achieve both revenue and earnings growth from newly acquired businesses; our ability to win against or displace competitors could be adversely affected by changes in the competitive landscape; as well as other risks and uncertainties referenced in Part II, Item 1A Risk Factors of this report.

Our Business

We develop, market and support product lifecycle management (PLM) and enterprise content management (ECM) software solutions and related services that help companies improve their processes for developing physical and information products.

Our software solutions include our Enterprise Solutions products a range of Internet-based collaboration, content and process management, and publishing technologies and our Desktop Solutions products a suite of mechanical computer-aided design, engineering calculation, and XML-based document authoring tools. Our software solutions help customers develop products faster, improve product quality, increase innovation and reduce product development cost.

The PLM market encompasses the mechanical computer-aided design, manufacturing and engineering (CAD, CAM and CAE) segment and the collaboration and product data management solutions segment, as well as many previously isolated markets that address various other phases of a product's lifecycle. These include but are not limited to 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, manufacturing planning, and technical and marketing publications.

The ECM market includes technologies for business process management, compliance management, document management, dynamic publishing, document archival and retrieval, knowledge management, records management and Web content management. Within the ECM market, PTC focuses on a subset of solutions that optimize the development of dynamic publications, such as those associated with technical manuals, service documents, and regulatory and compliance data sets, as well as government and financial document publishing and content management.

Executive Overview

Total revenue in the third quarter of 2007 was \$224.9 million, reflecting 4% year-over-year growth. While our revenue grew on a year-over-year basis, our license revenue and operating margins were below our expectations and reflected mixed revenue performance across geographic areas and product categories. Our third quarter license revenue performance reflects two major factors: (1) several large transactions that we expected to close did not close and (2) a reduction in add-on sales of Desktop Solutions in North America and Japan. In the third quarter of 2007, we continued to see strong revenue growth in Enterprise Solutions and our maintenance revenue was \$103.1 million, the highest amount of quarterly maintenance revenue we have ever recorded. We believe this strong maintenance revenue is an indicator that we have a large and loyal customer base that continues to benefit from the use of our differentiated solutions. While our revenue performance in the third quarter of 2007 was lower than our expectations, we continue to believe that the overall PLM market is growing and will continue to grow as customers invest in solutions that help them improve their product development processes.

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Net income for the third quarter and first nine months of 2007 was significantly higher year over year due to non-cash tax benefits recorded in the quarter primarily associated with our reversal of valuation allowances in the U.S. and a foreign jurisdiction. Based upon our operating results over recent years and through June 30, 2007 as well as an assessment of our expected future operating results, we determined that it had become more likely than not that we will realize a substantial portion of our deferred tax assets in the U.S. and a foreign jurisdiction. As a result, during the third quarter of 2007, we reversed the valuation allowance against certain deferred tax assets in the U.S. and a foreign jurisdiction, resulting in a tax benefit of \$58.9 million, a decrease to goodwill of \$20.0 million, and an increase in stockholders' equity of \$0.9 million.

We believe operating results for the first nine months of 2007, during which revenue grew 12% year over year and operating margins improved, reflect the trends in our business better than the results of the third quarter of 2007 alone. These nine-month results reflect growth across our lines of business, growth in both our Desktop Solutions and Enterprise solutions product categories, growth across our three major geographies, and growth in revenue from customers of all sizes. We believe these nine-month operating results reflect successful execution of our strategic initiatives over the past three years as well as increased technology spending by our customers. Those initiatives focused on improving our product and service offerings, our distribution model, our strategic account relationships, our competitive position and our marketing programs. We believe our strategic initiatives have created three key competitive differentiators which we believe are causing customers to adopt our solutions: our broad product development system capabilities, our single platform architecture, and our unique process framework for addressing our customers' product development challenges. In particular, we believe our strategy to offer a product development system with fully integrated solutions on a common architecture provides us with a significant competitive advantage and is a major factor in our increased sales of Pro/ENGINEER® and Windchill®. We also believe that acquisitions by others of certain of our competitors create competitive opportunities for us.

As a result of third quarter revenue being lower than our expectations and as part of our ongoing efforts to deliver operating margin growth, we have taken recent steps to reduce costs. In the fourth quarter of 2007, we expect to terminate the employment of approximately 200 employees, which will result in a restructuring charge for severance and related costs of approximately \$11 million in the fourth quarter of 2007. Additionally, we are evaluating other cost savings opportunities including optimizing the use of our leased facilities worldwide and relocating functions to lower-cost geographies. This evaluation may result in additional restructuring costs in the fourth quarter of 2007 and in 2008. We expect these planned restructuring initiatives will help us to improve operating margins and increase our strategic presence in emerging geographies.

Other Important Information

On August 2, 2007, GE Capital Leasing Corporation (GELC) filed a lawsuit against PTC alleging that PTC was a participant in an alleged scheme in which an employee of Toshiba Corporation fraudulently induced GELC to provide over \$60 million in financing for purchases of third party products, including PTC software, during the period from 2003 to 2006. GELC alleges that the scheme commenced in or about late 2000, prior to GELC's involvement. GELC alleges that the Toshiba employee was not authorized to undertake the orders or enter into the financing agreements. GELC further alleges that PTC was aware of this lack of authority. All of the alleged transactions occurred in Japan. GELC has alleged that PTC and other alleged participants have received and recorded at least \$47 million in funds from GELC. We are investigating this matter and, based on our investigation to date, believe revenue was properly recognized on the applicable transactions. If our investigation were to conclude that certain of GELC's allegations were true, PTC could be required to reverse all or a portion of the revenue associated with the applicable transactions, which could result in a restatement of our previously issued financial statements. Additionally, we cannot predict the ultimate resolution of the GELC lawsuit at this time, but, if determined adversely to us, this lawsuit could have a material adverse impact on our financial condition or results of operations.

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The following is a summary of our results of operations for the third quarters and first nine months of 2007 and 2006, which includes the results of operations of companies we acquired beginning on their respective acquisition dates.

	Three months ended			Nine months ended		
	June 30, 2007	July 1, 2006	Percent Change	June 30, 2007	July 1, 2006	Percent Change
	(Dollar amounts in millions)					
Total revenue	\$ 224.9	\$ 215.6	4%(1)	\$ 674.6	\$ 603.7	12%(1)
Total costs and expenses	205.3	203.3	1%	612.8	570.1	7%
Operating income	19.6	12.3		61.8	33.6	
Other income (expense), net	2.2	0.8		4.4	2.7	
Income before income taxes	21.8	13.1		66.2	36.3	
(Benefit from) provision for income taxes	(58.6)	(2.8)		(46.8)	6.5	
Net income	\$ 80.4	\$ 15.9		\$ 113.0	\$ 29.8	

(1) On a consistent foreign currency basis, compared to the year-ago periods, total revenue for the third quarter and first nine months of 2007 increased 2% and 9%, respectively.

Revenue results for the third quarter and first nine months of 2007 are described below in Revenue.

Total costs and expenses reflect increases in our operating cost structure from acquisitions and from measured increases to support planned revenue growth. Refer to Costs and Expenses beginning on page 34 for a more detailed discussion.

The increase in operating income in the third quarter and first nine months of 2007 compared to 2006 is favorably impacted by lower stock-based compensation expense and restructuring charges in the 2007 periods as compared to the 2006 periods. In addition, as described in Executive Overview beginning on page 26 and in Costs and Expenses, net income in the third quarter and first nine months of 2007 includes a \$58.9 million tax benefit due to the reversal of a significant portion of our valuation allowances against deferred tax assets in the U.S. and in a foreign jurisdiction.

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The following table shows certain consolidated financial data as a percentage of our total revenue for the third quarters and first nine months of 2007 and 2006:

	Three months ended		Nine months ended	
	June 30,	July 1,	June 30,	July 1,
	2007	2006	2007	2006
Revenue:				
License	28%	30%	30%	30%
Service	72	70	70	70
Total revenue	100	100	100	100
Costs and expenses:				
Cost of license revenue	2	1	2	1
Cost of service revenue	30	30	30	31
Sales and marketing	33	33	32	33
Research and development	18	17	18	18
General and administrative	7	8	8	9
Amortization of acquired intangible assets	1	1	1	1
Restructuring charges		3		1
In-process research and development		1		
Total costs and expenses	91	94	91	94
Operating income	9	6	9	6
Other income (expense), net	1		1	
Income before income taxes	10	6	10	6
(Benefit from) provision for income taxes	(26)	(1)	(7)	1
Net income	36%	7%	17%	5%

Revenue

Our revenue consists of software license revenue and service revenue, which includes software maintenance revenue (consisting of providing our customers software updates and technical support) as well as consulting and training revenue (including implementation services).

We report our revenue in two product categories:

Enterprise Solutions, which includes Windchill, Pro/INTRALINK, ProductView, Arbortext Publishing Engine, Arbortext IsoView and all other solutions that help companies collaborate and manage and publish information across an extended enterprise; and

Desktop Solutions, which includes Pro/ENGINEER, Arbortext Editor, Arbortext IsoDraw, Mathcad and all other solutions that help companies create content and improve desktop productivity.

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The following table shows our software license revenue and our service revenue by product category for the periods stated.

	Three months ended			Nine months ended		
	June 30, 2007	July 1, 2006	Percent Change	June 30, 2007	July 1, 2006	Percent Change
	(Dollar amounts in millions)					
License revenue:						
Enterprise	\$ 23.9	\$ 22.2	8%	\$ 69.8	\$ 64.6	8%
Desktop	38.2	43.5	(12)%	130.2	114.3	14%
Total license revenue	62.1	65.7	(5)%	200.0	178.9	12%
Maintenance revenue:						
Enterprise	20.5	17.5	17%	58.9	49.9	18%
Desktop	82.6	76.6	8%	243.5	222.0	10%
Total maintenance revenue	103.1	94.1	10%	302.4	271.9	11%
Consulting and training service revenue:						
Enterprise	41.5	32.9	26%	116.4	92.4	26%
Desktop	18.2	22.9	(21)%	55.8	60.5	(8)%
Total consulting and training service revenue	59.7	55.8	7%	172.2	152.9	13%
Total service revenue	162.8	149.9	9%	474.6	424.8	12%
Total revenue	\$ 224.9	\$ 215.6	4%(1)	\$ 674.6	\$ 603.7	12%(1)
Total Enterprise Solutions revenue	\$ 85.9	\$ 72.6	18%	\$ 245.1	\$ 206.9	18%
Total Desktop Solutions revenue	\$ 139.0	\$ 143.0	(3)%	\$ 429.5	\$ 396.8	8%

(1) On a consistent foreign currency basis from the comparable year-ago period, in the third quarter and first nine months of 2007 total revenue increased 2% and 9%, respectively.

Our results include the highest amount of quarterly maintenance revenue we have recorded, as well as growth in Europe across both product categories and all lines of business. Growth in these areas was offset by declines in Desktop Solutions license revenue in North America and Japan and a decline in channel revenue in Asia-Pacific. Our

nine-month year-over-year revenue growth in both Desktop Solutions and Enterprise Solutions reflects both organic growth of our Desktop Solutions and Enterprise Solutions and revenue from the Mathsoft and ITEDO businesses acquired on April 28, 2006 and October 18, 2006, respectively. Historically, Mathsoft generated revenue of approximately \$20 million for the twelve months ended March 31, 2006 and ITEDO generated revenue of approximately \$5 million for the twelve months ended July 31, 2006. The Mathsoft and ITEDO businesses have been included in our results of operations since their acquisition dates. Accordingly, results for the third quarter and first nine months of 2006 do not include ITEDO and include Mathsoft only since April 28, 2006.

Total revenue from our Enterprise Solutions software and related services was 38% and 34% of our total revenue in the third quarter of 2007 and 2006, respectively, and 36% and 34% of our total revenue in the first nine months of 2007 and 2006, respectively. The increase in Enterprise Solutions revenue in the third quarter and first nine months of 2007 compared to the third quarter and first nine months of 2006 was due primarily to:

- organic growth of our Windchill solutions, which we believe reflects our success in helping customers understand the benefits of investing in PLM solutions, as well as our ability to help customers adopt our solutions incrementally, which lowers customer risk, and
- more wide-spread adoption of our solutions by both our existing and new customers, which we believe is a result of customer recognition of the benefits of our broad set of capabilities delivered on a single system architecture.

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Total revenue from our Desktop Solutions software and related services was 62% and 66% of our total revenue in the third quarter of 2007 and 2006, respectively, and 64% and 66% of our total revenue in the first nine months of 2007 and 2006, respectively. The decrease in Desktop Solutions revenue in the third quarter of 2007 as compared to the third quarter of 2006 reflects:

declines in license revenue in Japan and North America, which reflect decreases in sales of new Pro/ENGINEER seats, modules and upgrades. This is due to our failure to close several large customer transactions that we had expected to close, as well as lower-than-expected revenue from medium-sized transactions, which typically include add-on sales of Pro/ENGINEER modules or upgrades to existing Pro/ENGINEER customers; and declines in Desktop Solutions service revenue, due to both anticipated and unplanned reductions in revenue from training services and computer-based training products.

These decreases were partially offset by:

growth in maintenance revenue, which we believe reflects continued customer satisfaction with PTC and our solutions;

growth in license and service revenue in the Pacific Rim, which primarily reflects increased sales of new seats of Pro/ENGINEER as well as related training services; and

revenue contribution from the acquired ITEDO and Mathsoft businesses.

In addition to Desktop Solutions revenue attributable to acquisitions, the increase in sales of our Desktop Solutions for the first nine months of 2007 was driven by increased sales of core Pro/ENGINEER solutions and reflects:

increased sales to small and medium-size businesses, and

increasing adoption of our Pro/ENGINEER products by customers who see adopting our integrated product development system as an advantage over maintaining their current environments, which typically consist of multiple, disconnected CAD and data management applications.

License Revenue

Total

License revenue accounted for 28% and 30% of total revenue in the third quarter and first nine months of 2007 and 30% and 30% of total revenue in the third quarter and first nine months of 2006, respectively. The decline in license revenue in the third quarter of 2007 compared to 2006 was primarily due to lower license revenue from large customer transactions. The growth in license revenue in the first nine months of 2007 compared to 2006 was due to revenue growth in customers of all sizes and across product categories.

Enterprise Solutions

The increase in Enterprise Solutions license revenue in the third quarter and first nine months of 2007 as compared to the third quarter and first nine months of 2006 came primarily from sales of Windchill PDMLink®, our core Windchill content and process management solution, as both existing and new customers adopt our Windchill solutions.

Desktop Solutions

The decrease in Desktop Solutions license revenue in the third quarter of 2007 compared to the third quarter of 2006 was due to lower sales of Pro/ENGINEER new seats, upgrades and modules, partially offset by higher revenue from sales of Arbortext IsoDraw and Mathcad. The increase in Desktop Solutions license revenue in the first nine months of 2007 compared to the first nine months of 2006 was due primarily to revenue contribution from sales of Mathcad

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and Arbortext IsoDraw as well as organic growth from sales of Pro/ENGINEER. For the first nine months of 2007, Pro/ENGINEER revenue grew across our high- and low-end packages, as well as upgrades and modules.

Maintenance Revenue

Total

Maintenance revenue represented 46% and 44% of total revenue in the third quarter of 2007 and 2006, respectively, and 45% of total revenue in the first nine months of both 2007 and 2006. Growth in our maintenance revenue was due to a higher number of seats on maintenance agreements and reflects continued success in improving customer satisfaction with our solutions, product enhancements and technical support.

Enterprise Solutions

Increases in our Enterprise Solutions maintenance revenue were due primarily to an increase in the number of new users of our Enterprise Solutions as new customers have been added and as existing customers have expanded their implementations to additional users.

Desktop Solutions

The increase in our Desktop Solutions maintenance revenue was due to a higher number of seats on maintenance agreements, growth of license revenue in prior periods, and revenue contributions from our acquired products.

Consulting and Training Service Revenue

Total

Consulting and training service revenue, which has a lower gross profit margin than license and maintenance revenues, accounted for 27% and 26% of total revenue in the third quarter of 2007 and 2006, respectively, and 26% and 25% of total revenue in the first nine months of 2007 and 2006, respectively. Consulting and training service revenue reflects an increase in consulting service revenue for each of the third quarter and first nine months of 2007, partially offset by a decrease in training service revenue for each of the third quarter and first nine months of 2007, compared to the year-ago periods.

Enterprise Solutions

Increases in our Enterprise Solutions consulting and training service revenue were due to increased customer demand for process and implementation consulting services as a result of increased adoption of our software solutions. Also, during 2007, our Enterprise Solutions consulting and training revenue included a large customer engagement in Europe which contributed to the growth in the 2007 periods as compared to the 2006 periods.

Desktop Solutions

Desktop Solutions consulting and training service revenue reflects a decrease in training service revenue for the third quarter and first nine months of 2007, partially offset by an increase in consulting service revenue for the same periods, as compared to the third quarter and first nine months of 2006. The decrease in Desktop Solutions training service revenue for the first nine months of 2007 was partially attributable to a large customer training order completed in the second quarter of 2006.

Table of Contents**Revenue by Geography**

The following table shows our revenue by geography for the periods stated.

	Three months ended			Nine months ended		
	June 30, 2007	July 1, 2006	Percent Change	June 30, 2007	July 1, 2006	Percent Change
(Dollar amounts in millions)						
Revenue by geography:						
North America	\$86.9	\$91.0	(5)%	\$262.8	\$244.9	7%
Europe	\$86.2	\$72.0	20%(1)	\$251.7	\$213.7	18%(2)
Asia-Pacific	\$51.8	\$52.6	(2)%(1)	\$160.1	\$145.1	10%(2)

(1) On a consistent foreign currency basis from the comparable year-ago period, in the third quarter of 2007 revenue in Europe increased 11% and revenue in Asia-Pacific increased 1%.

(2) On a consistent foreign currency basis from the comparable year-ago period, in the first nine months of 2007 revenue in Europe increased 9% and revenue in Asia-Pacific increased 12%.

We derived 61% of our total revenue from sales to customers outside North America in both the third quarter and first nine months of 2007, compared to 58% and 59% in the third quarter and first nine months of 2006, respectively.

North America. Total revenue growth for the first nine months of 2007 in North America was primarily due to organic growth and contributions from the acquired Mathsoft business, whose revenues were concentrated in that region.

North American revenue performance for the first nine months of 2007 also reflects positive results from our strategic account program and from our indirect channel. The revenue decline in North America in the third quarter of 2007 was due primarily to lower Desktop Solutions license and service revenue, partially offset by higher maintenance revenue in both product categories and higher Enterprise Solutions license revenue.

Europe. The increase in European revenue in the third quarter of 2007 compared to the third quarter of 2006 reflects organic growth in Enterprise license revenue and Desktop and Enterprise Solutions maintenance revenue, and

contributions from the Mathsoft and ITEDO acquisitions, and was favorably impacted by foreign currency exchange rates. European revenue for the first nine months of 2007 included a large customer Enterprise Solutions consulting and training engagement, while revenue for the first nine months of 2006 included a large license transaction from the same customer completed in the first quarter.

Asia-Pacific. Revenue performance in Asia-Pacific for the third quarter of 2007 compared to the third quarter of 2006 reflected a 9% increase in revenue in the Pacific Rim and a 15% decrease in revenue in Japan. Revenue for the first nine months of 2007 compared to the first nine months of 2006 reflected a 13% increase in the Pacific Rim and a 7% increase in Japan. We believe that the growth in the Pacific Rim reflects better execution after strategic and organizational changes we made in that region in 2006 and a growing market opportunity particularly, strong demand for our PLM solutions in China. Revenue performance in Japan in the first nine months of 2007 reflected strong first quarter revenue relative to recent quarters and included revenue from a relatively large customer transaction completed in the first quarter. Our results in Japan continue to be adversely affected by unfavorable industry conditions, as well as our own execution challenges. We continue to focus on improving results in Japan, but we expect that such improvement will take some time and extend into 2008.

Revenue from Individual Customers

We enter into customer contracts that may result in revenue being recognized over multiple reporting periods. Accordingly, revenue recognized in a current quarter may be attributable to contracts entered into during the current period or in prior periods. License and/or consulting and training service revenue of \$1 million or more recognized from individual customers in the third quarter and first nine months of 2007 was \$34.7 million and \$98.5 million, respectively, and in the third quarter and first nine months of 2006 was \$35.5 million and \$84.9 million, respectively. The third quarter of 2007 results include 17 customers with license and service revenue over \$1 million each, compared to 16 such customers in the third quarter of 2006, reflective of continued success in our strategic account program. While the level of license and service revenue greater than \$1 million from individual customers in the third quarter of 2007 was relatively flat compared to the year-ago period, Enterprise Solutions revenue from such transactions was higher than the year-ago period and Desktop Solutions was lower, and, overall, we experienced lower than expected revenue in the quarter from large transactions due to the fact that some transactions that we expected to close in the quarter did not close. Additionally, the license component of our larger transaction revenue declined, while services revenue increased, which adversely impacted our operating margins. While our customers may not continue to spend at these levels in future periods, we believe the strong performance in 2006 and the first nine months of 2007 is the result of a shift in customer priorities toward PLM solutions relative to other

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IT spending initiatives, our improved ability to provide broader solutions to our customers, and improvements in our competitive position due to our system architecture and product development process knowledge.

Channel Revenue

Total sales from our reseller channel, which are primarily for our Desktop Solutions, grew 3% and 15% to \$47.6 million and \$143.8 million in the third quarter and first nine months of 2007, respectively, from \$46.0 million and \$124.7 million in the third quarter and first nine months of 2006, respectively. Sales from our reseller channel comprised 21% of total revenue for both the third quarter and first nine months of 2007 compared to 21% and 20% of total revenue for the third quarter and first nine months of 2006, respectively. Channel revenue results reflect revenue growth in our reseller channel in North America and Europe in the third quarter and first nine months of 2007, partially offset by lower revenue in Asia-Pacific.

Costs and Expenses

Over the past several years, we have made significant investments to transform our business from providing a single line of technical software with a largely direct distribution model, supplemented by a small number of channel partners, to providing integrated product development system solutions with an expanded channel and partner-involved distribution model. As part of this effort, we broadened our product development system through a series of eight acquisitions completed and substantially integrated since the third quarter of 2004.

While we intend to continue to invest in our strategic initiatives to support planned revenue growth and to fund revenue-generating initiatives, we remain focused on achieving our operating margin goals. Accordingly, we are taking steps to improve operating margins. In the fourth quarter of 2007, we expect to terminate the employment of approximately 200 employees, which will result in a restructuring charge for severance and related costs of approximately \$11 million in the fourth quarter of 2007. Additionally, we are evaluating other cost savings opportunities including optimizing the use of our leased facilities worldwide and relocating functions and additional workforce to lower- cost geographies. This process may result in additional restructuring costs in the fourth quarter of 2007 and in 2008. We expect these planned restructuring initiatives will help us to improve operating margins while continuing to grow the business and increase our strategic presence in emerging geographies.

The following table shows our costs and expenses by expense category for the periods stated.

	Three months ended			Nine months ended		
	June 30, 2007	July 1, 2006	Percent Change	June 30, 2007	July 1, 2006	Percent Change
(Dollar amounts in millions)						
Costs and expenses:						
Cost of license revenue	\$ 4.1	\$ 3.0	36%	\$ 11.9	\$ 8.2	45%
Cost of service revenue	67.7	65.6	3%	204.9	188.2	9%
Sales and marketing	74.6	70.0	6%	215.7	198.2	9%
Research and development	39.8	36.9	8%	117.9	107.5	10%
General and administrative	16.8	18.0	(7)%	56.5	55.7	1%
Amortization of acquired intangible assets	1.8	1.7	7%	5.4	4.3	27%
Restructuring charges		5.9	(100)%		5.9	(100)%
In-process research and development	0.5	2.1	(74)%	0.5	2.1	(74)%
Total costs and expenses	\$ 205.3	\$ 203.2	1%(1)	\$ 612.8	\$ 570.1	7%(1)

(1) On a consistent foreign currency

basis from the prior period, total costs and expenses decreased 1% and increased 5% in the third quarter and first nine months of 2007, respectively, compared to the third quarter and first nine months of 2006.

Headcount increased to 4,676 at June 30, 2007 from 4,309 at September 30, 2006 and 4,233 at July 1, 2006. Our increases in costs and expenses in the first nine months of 2007 were primarily due to the following:

increases in services delivery capacity to address anticipated customer demand for consulting services; and

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the Mathsoft and ITEDO acquisitions completed in the third quarter of 2006 and the first quarter of 2007, respectively, which added operating costs and increased headcount.

Cost of License Revenue

Our cost of license revenue includes fixed and variable costs associated with reproducing and distributing software and documentation; royalties paid to third parties for technology embedded in or licensed with our software products; and amortization of purchased software attributable to recent acquisitions. Cost of license revenue as a percentage of license revenue was 7% and 5% for the third quarter of 2007 and 2006, respectively, and 6% and 5% for the first nine months of 2007 and 2006, respectively. The increase in cost of license revenue in the third quarter and first nine months of 2007 compared to the third quarter and first nine months of 2006 was due primarily to higher amortization of purchased software attributable to recent acquisitions, which was \$0.6 million and \$2.2 million higher, respectively. Additionally, royalty expense was \$0.2 million and \$0.9 million higher in the third quarter and first nine months of 2007, respectively, compared to the year-ago periods. 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 and the level of amortization of acquired software intangible assets.

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; costs associated with the release of maintenance updates (including related royalty costs); and facility costs. Cost of service revenue as a percentage of service revenue was 42% and 44% in the third quarter of 2007 and 2006, respectively and 43% and 44% in the first nine months of 2007 and 2006, respectively. Service margins can vary based on the product mix sold in the period. Service-related headcount increased to 1,317 at June 30, 2007 from 1,291 at September 30, 2006 and 1,266 at July 1, 2006. Total compensation, commissions, benefits and travel costs were \$1.0 million and \$9.6 million higher in the third quarter and first nine months of 2007, respectively, compared to the third quarter and first nine months of 2006 due to planned increases in our services delivery capacity. The cost of third-party consulting services was \$1.1 million and \$4.7 million higher in the third quarter and first nine months of 2007, respectively, compared to the third quarter and first nine months of 2006, due to the use of such services in support of increases in consulting and training service revenue.

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 33% and 32% for the third quarter and first nine months of 2007, respectively, and 33% for both the third quarter and first nine months of 2006. Sales and marketing headcount increased to 1,215 at June 30, 2007 from 1,145 at September 30, 2006 and 1,134 at July 1, 2006. As a result of increases in headcount, primarily due to acquisitions, and higher commissions in the first six months of 2007 due to revenue growth, our compensation and benefit costs, sales commissions and travel expenses were higher by an aggregate of \$2.7 million and \$13.5 million in the third quarter and first nine months of 2007 compared to the third quarter and first nine months of 2006, respectively.

Research and Development

Our research and development expenses consist principally of salaries and benefits, costs of computer equipment and facility expenses. Major research and development activities include developing new releases of our software that work together in a more integrated fashion and that include functionality enhancements. Research and development expenses as a percentage of total revenue were 18% and 17% in third quarter of 2007 and 2006, respectively, and 18% in both the first nine months of 2007 and 2006. Research and development headcount increased to 1,656 at June 30, 2007 from 1,437 at September 30, 2006 and 1,392 at July 1, 2006. As a result of these increases in headcount, total compensation, benefits and travel costs were higher in the third quarter and first nine months of 2007 compared to the third quarter and first nine months of 2006 by an aggregate of \$2.4 million and \$9.7 million, respectively.

Table of Contents*General and Administrative*

Our general and administrative expenses include the costs of our corporate, finance, information technology, human resources, legal and administrative functions as well as bad debt expense. General and administrative expenses as a percentage of total revenue were 7% and 8% in the third quarter of 2007 and 2006, respectively, and 8% and 9% in the first nine months of 2007 and 2006, respectively. General and administrative headcount was 469 at June 30, 2007, up from 420 at September 30, 2006 and 424 at July 1, 2006. Total compensation, benefits and travel costs were lower in the third quarter of 2007 compared to the third quarter of 2006 by an aggregate of \$1.7 million and higher in the first nine months of 2007 compared to the first nine months of 2006 by an aggregate of \$1.2 million. The decrease in the third quarter of 2007 was due primarily to lower stock-based compensation expense of \$2.3 million which is due primarily to the reversal in that quarter of all expense for 2007 performance-based restricted shares and restricted stock units that we currently do not expect will be earned. General and administrative expenses include costs associated with outside professional services, including accounting and legal fees. The second quarter of 2007 included higher costs for outside professional services incurred in connection with our corporate development initiatives. The first quarter of 2006 included higher costs for outside professional services incurred in connection with our investigation in the Asia-Pacific region described in our 2005 Annual Report on Form 10-K.

Amortization of Acquired Intangible Assets

These costs represent the amortization of acquired intangible assets. The increase in expense in the third quarter and first nine months of 2007 compared to the third quarter and first nine months of 2006 was due primarily to amortization of intangible assets resulting from the NC Graphics, ITEDO and Mathsoft acquisitions completed in the third quarter of 2007, the first quarter of 2007 and the third quarter of 2006, respectively.

Other Income (Expense), net

Other income (expense), net includes interest income, interest expense, costs of hedging contracts, certain realized and unrealized foreign currency transaction gains or losses, charges incurred in connection with obtaining corporate and customer contract financing, 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 are transacted in foreign currencies. To reduce our exposure to fluctuations in foreign exchange rates, we engage in hedging transactions involving the use of foreign currency forward contracts, primarily in the Euro and Asian currencies. Other income (expense), net was \$2.3 million and \$0.8 million for the third quarter of 2007 and 2006, respectively, and \$4.4 million and \$2.7 million for the first nine months of 2007 and 2006, respectively. The increase in other income (expense), net in the third quarter and first nine months of 2007 is due primarily to higher interest income, partially offset by higher foreign exchange losses and other expense of \$0.7 million recorded in the second quarter of 2007 related to the settlement of a disputed obligation related to a previously divested business unit.

Income Taxes

In the third quarter of 2007, our effective tax rate was a benefit of 268% on pre-tax income of \$21.8 million compared to a benefit of 21% in the third quarter of 2006 on pre-tax income of \$13.2 million. In the first nine months of 2007, our effective tax rate was a benefit of 71% on pre-tax income of \$66.2 million compared to an expense of 18% in the first nine months of 2006 on pre-tax income of \$36.3 million. The net tax benefit recorded in those 2007 periods was principally due a tax benefit of \$58.9 million recorded upon our decision in the third quarter of 2007 to release a substantial portion of the valuation allowance recorded against net deferred tax assets in the U.S. and a foreign jurisdiction as well as a tax benefit of \$3.9 million recorded in the third quarter of 2007 from the favorable outcome of a tax refund claim in the U.S. The net tax benefit recorded in third quarter of 2006 was due to a benefit of \$6.1 million realized upon the favorable resolution of a tax audit in the U.S. Excluding each of these one-time benefits, our effective tax rates were 19% and 25% in the third quarters of 2007 and 2006, respectively, and 24% and 35% in the first nine months of 2007 and 2006, respectively. For the third quarters of 2007 and 2006 and the first nine months of 2007, our effective tax rates excluding those one-time tax benefits were lower than the statutory federal income tax rate of 35% due primarily to our use of net operating loss carryforwards (NOLs) to offset our U.S. taxable income (which reduced the valuation allowance we had previously recorded against those NOLs) and to taxes owed in foreign jurisdictions at tax rates lower than the U.S. statutory tax rate, partially offset by the impact of losses in foreign

jurisdictions that could not be benefited, as well as withholding taxes that we incurred in the U.S. in connection with certain foreign operations.

As of the end of the second quarter of 2007, a full valuation allowance was recorded against our net deferred tax assets (consisting primarily of operating loss carryforwards) in the U.S. and certain foreign jurisdictions. Based upon our operating results over recent years and through June 30, 2007 as well as an assessment of our expected future results of operations, during the third quarter of 2007, we determined that it had become more likely than not that we will realize a substantial portion of our net deferred tax assets in the U.S. and a foreign jurisdiction. As a result, during the third quarter, we released a total of \$79.8 million of our valuation allowances. Of the \$79.8 million valuation allowance release, \$58.9 million was recorded as a one-time income tax benefit, \$20.0 million was recorded as a reduction to goodwill recorded upon prior acquisitions, and \$0.9 million was recorded as a decrease to accumulated other comprehensive loss within stockholders' equity.

Our future effective tax rate may be materially impacted by the amount of income taxes associated with our foreign earnings, which are taxed at rates different from the U.S. federal statutory rate, as well as the timing and extent of the realization of deferred tax assets and changes in the tax law. Further, our tax rate may fluctuate within a fiscal year, including from quarter to quarter, due to items arising from discrete events, including settlements of tax audits and assessments; the resolution or identification of tax position uncertainties; and acquisitions of other companies.

Table of Contents**Liquidity and Capital Resources**

	June 30, 2007	July 1, 2006
	(in thousands)	
Cash and cash equivalents	\$ 259,956	\$ 173,893
Amounts below are for the nine months ended:		
Cash provided by operating activities	\$ 115,072	\$ 53,463
Cash used by investing activities	(45,657)	(88,149)
Cash provided by financing activities	5,493	2,730
Cash provided by operating activities included the following:		
Cash disbursements for restructuring charges	(5,522)	(11,227)
Federal income tax audit settlement payments		(9,488)
Cash used by investing activities included the following:		
Cash paid to acquire businesses, net of cash acquired	(24,546)	(75,084)

Cash and cash equivalents

We invest our cash with highly-rated financial institutions and in diversified domestic and international money market mutual funds. The portfolio is invested in short-term instruments to ensure that cash is available to meet requirements as needed. At June 30, 2007, cash and cash equivalents totaled \$260.0 million, up from \$183.4 million at September 30, 2006. The increase in cash and cash equivalents in the first nine months of 2007 is due primarily to \$115.1 million of cash provided by operations, partially offset by \$24.5 million paid for acquisitions, primarily ITEDO and NC Graphics, and \$17.1 million for additions to property and equipment.

Cash provided by operating activities

Cash provided by operating activities was \$115.1 million in the first nine months of 2007 compared to cash provided by operating activities of \$53.5 million in the first nine months of 2006. This change was due primarily to higher net income and improved customer collections in the first nine months of 2007 compared to the first nine months of 2006. The lower cash provided by operations in the first nine months of 2006 was also impacted by higher income tax payments in 2006, including a \$9.5 million payment to the IRS in the third quarter of 2006 as a result of the settlement of tax audits during the third quarter. In addition, we made a cash contribution to our U.S. defined benefit pension plan of \$4.2 million in the first quarter of 2006. We did not make any contributions to our U.S. defined benefit pension plan in 2007.

Days sales outstanding (DSO) was 69 days as of the end of the third quarter of 2007 compared to 68 days as of the end of the third quarter of 2006 and 67 days at September 30, 2006. DSO in the third quarter of 2007 improved from 74 days and 80 days as of the end of the second quarter and first quarters of 2007, respectively. DSO at the end of the first, second and third quarters of 2007 compared to year-ago periods were adversely affected by the amount of extended payment term deals we offered to customers during 2006 and the first half of 2007. We offer these terms to some customers with established payment and credit histories.

We provided extended payment terms on internally financed transactions accounting for approximately \$51 million of revenue in 2006, and \$22 million and \$26 million in the first nine months of 2007 and 2006, respectively. Other assets in the accompanying consolidated balance sheets include non-current receivables from customers related to extended payment term contracts totaling \$25.9 million and \$31.1 million at June 30, 2007 and September 30, 2006, respectively.

Cash used by investing activities

Cash used by investing activities was \$45.7 million in the first nine months of 2007 compared to \$88.1 million in the first nine months of 2006. The decrease in cash used by investing activities in the first nine months of 2007 was primarily due to lower disbursements for acquisitions of \$24.5 million in the first nine months of 2007, including \$7.2 million and \$16.7 million for the NC Graphics and ITEDO acquisitions, respectively, compared to disbursements of \$88.1 million in the first nine months of 2006 which included \$64.4 million for the Mathsoft acquisition. Further,

during the third quarter of 2007 we acquired the remaining equity interest in a controlled

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subsidiary for \$4.0 million. In addition, cash used for additions to property and equipment increased to \$17.1 million in the first nine months of 2007 compared to \$13.1 million in the first nine months of 2006, primarily as a result of increased headcount. Our expenditures for property and equipment consist primarily of computer equipment, software, office equipment and facility improvements.

Cash provided by financing activities

Cash provided by financing activities was \$5.5 million and \$2.7 million in the first nine months of 2007 and 2006, respectively. The increase in 2007 compared to 2006 is primarily due to higher proceeds from the issuance of common stock upon the exercise of stock options, which were \$13.9 million in the first nine months of 2007 compared to \$4.1 million in the first nine months of 2006. During the first nine months of 2007, we used \$6.5 million to pay employee withholding taxes related to restricted stock units that vested during the period in lieu of issuing shares to employees with respect to those awards. In addition, in the third quarter of 2007, we repurchased 100,000 shares of our common stock for \$1.8 million.

Credit Facility

On February 21, 2006, we entered into a multi-currency bank revolving credit facility. The credit facility consists of a \$230 million revolving credit facility, which may be increased by up to an additional \$150 million if the existing or additional lenders are willing to make such increased commitments. The credit facility expires on February 20, 2011, when all amounts will be due and payable in full. We expect to use the credit facility for general corporate purposes, including acquisitions of businesses. We have not borrowed any funds under the credit facility to date.

The credit facility limits our and our subsidiaries' ability to take certain actions and requires that we and our subsidiaries maintain specified leverage and fixed-charge ratios. These limitations are described in Note 11 to our unaudited Consolidated Financial Statements located in Part I, Item 1 of this report. We were in compliance with all financial and operating covenants of the credit facility as of June 30, 2007.

Share Repurchase Authorization

In September 1998, our Board of Directors authorized the repurchase of up to 8.0 million shares of our common stock and in July 2000 increased the shares authorized for repurchase to 16.0 million. We repurchased 12.5 million shares through the end of 2004 and did not repurchase any additional shares until the third quarter of 2007 when our Board of Directors authorized us to resume repurchases within established parameters (described in Part II, Item 2 of this report). In the third quarter of 2007, we repurchased 100,000 shares for \$1.8 million. Through the end of the third quarter of 2007, we had repurchased, at a cost of \$368.6 million, a total of 12.6 million shares of the 16.0 million shares authorized for repurchase. In the fourth quarter of 2007 to date, we have repurchased an additional 457,000 shares for \$8.2 million.

Liquidity Expectations for Fiscal 2007

We believe that existing cash and cash equivalents together with cash we expect to generate from operations will be sufficient to meet our working capital and capital expenditure requirements through at least the next twelve months. During the remainder of 2007, we expect to make cash disbursements estimated at \$9 million for restructuring charges incurred in the fourth quarter of 2007 and for restructuring charges incurred in 2006 and prior periods; capital expenditures of approximately \$5 million; and a contribution of approximately \$7 million to a non-US pension plan. We also resolved a prior tax refund claim with the IRS in the third quarter of 2007 for which we recorded an income tax benefit of \$3.9 million during the quarter, and we expect to receive the related tax refund of \$5.6 million in the fourth quarter of 2007.

We have evaluated, and expect to continue to evaluate, possible strategic transactions on an ongoing basis and at any given time may be engaged in discussions or negotiations with respect to possible strategic transactions. Our cash position could be reduced and we may incur debt obligations to the extent we complete any significant transactions.

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Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are set forth under the heading *Critical Accounting Policies and Estimates* in Part II, Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations* of our 2006 Annual Report on Form 10-K. There have been no changes to these policies and no significant changes to these estimates since September 30, 2006.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Effectiveness of Disclosure Controls and Procedures

Our management maintains 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*) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), as appropriate, to allow for timely decisions regarding required disclosure.

We, under the supervision and with the participation of our management, including our principal executive and principal financial officers, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2007 in connection with the filing of the Original Form 10-Q. Based on that evaluation, we concluded at that time that our disclosure controls and procedures were effective.

Subsequent to the evaluation made in connection with the filing of the Original Form 10-Q, and in connection with the restatement of our prior period financial statements described in Part I, Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* of this Form 10-Q/A and the filing of this Form 10-Q/A, we, under the supervision and with the participation of our management, including our principal executive and principal financial officers, re-evaluated the effectiveness of the design and operation of our disclosure controls and procedures and concluded that, because the material weakness in our internal control over financial reporting described below existed at that time, our disclosure controls and procedures were not effective as of June 30, 2007.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

Subsequent to the filing of the Original Form 10-Q, we identified a material weakness in our internal control over financial reporting in that we did not maintain effective controls over the accounting for income taxes, including the determination and reporting of accrued income taxes, deferred taxes and the related income tax provision.

Specifically, we did not have adequate personnel to enable us to properly consider and apply generally accepted accounting principles for taxes, review and monitor the accuracy and completeness of the components of the income tax provision calculations and the related deferred taxes and accrued income taxes, ensure that the rationale for certain tax positions was appropriate, and ensure that effective oversight of the work performed by our outside tax advisors was exercised. This material weakness resulted in the restatement of our unaudited interim consolidated financial statements as of and for the period ended June 30, 2007. In addition, until remediated, this material weakness could result in a misstatement in the tax-related accounts described above that would result in a material misstatement to our interim or annual consolidated financial statements and disclosures that would not be prevented or detected.

Notwithstanding the existence of this material weakness, we have concluded that the consolidated financial statements in this Form 10-Q/A fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented.

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Remediation Initiatives

Our management is in the process of actively addressing and remediating the material weakness in internal control over financial reporting described above. During 2008, we will undertake the following actions to remediate the material weakness identified:

Hire additional personnel and retain professional advisors trained and experienced in income tax accounting;

Re-evaluate the design of income tax accounting processes and controls and implement new and improved processes and controls, if warranted; and

Increase the level of review and discussion of significant tax matters and supporting documentation with senior finance management.

As part of our 2008 assessment of internal control over financial reporting, our management will conduct sufficient testing and evaluation of the controls to be implemented as part of this remediation plan to ascertain that they operate effectively.

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) that occurred during the third fiscal quarter ended June 30, 2007 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 6. EXHIBITS

- 31.1 Certification of the Chief Executive Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
- 31.2 Certification of the Chief Financial Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
- 32* Certification of Periodic Financial Report Pursuant to 18 U.S.C. Section 1350.

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

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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: December 11, 2007