

Piedmont Office Realty Trust, Inc.
Form S-3ASR
June 04, 2013
Table of Contents

As filed with the Securities and Exchange Commission on June 4, 2013

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form S-3

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

PIEDMONT OFFICE REALTY TRUST, INC.*

(Exact name of registrant as specified in its charter)

Maryland
(State or Other Jurisdiction of

Incorporation or Organization)

58-2328421
(I.R.S. Employer

Identification No.)

11695 Johns Creek Parkway

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Suite 350

Johns Creek, Georgia 30097-1523

(770) 418-8800

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Robert E. Bowers

Chief Financial Officer, Executive Vice President and Treasurer

Piedmont Office Realty Trust, Inc.

11695 Johns Creek Parkway, Suite 350

Johns Creek, Georgia 30097-1523

(770) 418-8800

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies requested to:

Keith M. Townsend

King & Spalding LLP

1180 Peachtree Street, N.E.

Atlanta, Georgia 30309

(404) 572-4600

* The company listed on the next page is also included in this Form S-3 registration statement as an additional Registrant.

Approximate date of commencement of proposed sale to the public: From time to time or at one time after the effective date of this registration statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. "

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If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box.

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Piedmont Office Realty Trust, Inc.

Large Accelerated Filer	<input checked="" type="checkbox"/>	Accelerated Filer	<input type="checkbox"/>
Non-Accelerated Filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company	<input type="checkbox"/>

Table of Contents**CALCULATION OF REGISTRATION FEE**

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price (1)	Amount of Registration Fee (2)
Common Stock, par value \$.01 per share, of Piedmont Office Realty Trust, Inc.	(3)	\$0
Preferred Stock, no par value, of Piedmont Office Realty Trust, Inc. (4)	(3)	\$0
Debt Securities of Piedmont Operating Partnership, LP (5)	(3)	\$0
Guarantee of Debt Securities of Piedmont Operating Partnership, LP by Piedmont Office Realty Trust, Inc.	(3)	(6)
Total	(3)	\$0

- (1) This registration statement registers an unspecified amount of securities of each identified class. No separate consideration will be received for common stock or preferred stock issued upon any conversion of the preferred stock registered hereunder. The proposed maximum aggregate offering per class of securities will be determined from time to time by the issuing registrant in connection with the offering of securities hereunder.
- (2) The registrants will pay registration fees pursuant to Rule 456(b) in connection with offerings of securities hereunder, and will update this table by post-effective amendment or prospectus filed pursuant to Rule 424(b) to indicate the aggregate offering price of the securities offered and the amount of the registration fees paid.
- (3) Not applicable pursuant to Rule 457(r) and General Instruction I.I.E. to Form S-3.
- (4) Includes the presently indeterminate number of shares of common stock, if any, as may be issued by Piedmont Office Realty Trust, Inc. upon any conversion of shares of preferred stock.
- (5) The debt securities will be non-convertible debt securities issued by Piedmont Operating Partnership, LP, a wholly-owned subsidiary of Piedmont Office Realty Trust, Inc.
- (6) No separate consideration will be received for the guarantee by Piedmont Office Realty Trust, Inc. of the debt securities of Piedmont Operating Partnership, LP. Pursuant to Rule 457(n), no registration fee is required with respect to the guarantee.

Table of Contents

ADDITIONAL REGISTRANT

Exact Name of Additional Registrant*	Jurisdiction of Formation	IRS Employer Identification No.
Piedmont Operating Partnership, LP	Delaware	58-2368838

* The address of the additional Registrant is 11695 Johns Creek Parkway, Suite 350, Johns Creek, Georgia 30097-1523.

Table of Contents

EXPLANATORY NOTE

This registration statement relates to securities which may be offered from time to time by Piedmont Office Realty Trust, Inc. (the Company) and Piedmont Operating Partnership, LP, the operating partnership of the Company (the Operating Partnership). This registration statement contains a form of basic prospectus relating to both the Company and the Operating Partnership which will be used in connection with an offering of securities by the Company or the Operating Partnership. The specific terms of the securities to be offered will be set forth in a prospectus supplement relating to the securities to be sold.

Table of Contents

PROSPECTUS

PIEDMONT OFFICE REALTY TRUST, INC.

Common Stock and Preferred Stock

PIEDMONT OPERATING PARTNERSHIP, LP

Debt Securities

Guarantee of Debt Securities of Piedmont Operating Partnership, LP by Piedmont Office Realty Trust, Inc.

We will provide the specific terms of these securities in supplements to this prospectus. You should read this prospectus and any applicable prospectus supplement carefully before you invest. We may offer and sell these securities from time to time in one or more offerings.

Each time that we sell securities under this prospectus, we will provide a prospectus supplement or other offering material that will contain specific information about the terms of that offering.

Piedmont Office Realty Trust, Inc. common stock is traded on the New York Stock Exchange under the symbol PDM .

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

This prospectus is dated June 4, 2013

Table of Contents

NO DEALER, SALESPERSON OR OTHER PERSON IS AUTHORIZED TO GIVE ANY INFORMATION OR TO REPRESENT ANYTHING NOT CONTAINED IN THIS PROSPECTUS OR ANY PROSPECTUS SUPPLEMENT. YOU MUST NOT RELY ON ANY UNAUTHORIZED INFORMATION OR REPRESENTATIONS. THIS PROSPECTUS AND ANY PROSPECTUS SUPPLEMENT CONSTITUTE AN OFFER TO SELL ONLY THE SECURITIES OFFERED HEREBY AND THEREBY, AND ONLY UNDER CIRCUMSTANCES AND IN JURISDICTIONS WHERE IT IS LAWFUL TO DO SO. THE INFORMATION CONTAINED IN THIS PROSPECTUS AND ANY PROSPECTUS SUPPLEMENT IS CURRENT ONLY AS OF THEIR RESPECTIVE DATES.

TABLE OF CONTENTS

<u>ABOUT THIS PROSPECTUS</u>	1
<u>PIEDMONT OFFICE REALTY TRUST, INC. AND PIEDMONT OPERATING PARTNERSHIP, LP</u>	1
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	2
<u>INCORPORATION OF CERTAIN INFORMATION BY REFERENCE</u>	2
<u>CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>	3
<u>RISK FACTORS</u>	4
<u>USE OF PROCEEDS</u>	5
<u>RATIOS OF EARNINGS TO FIXED CHARGES AND TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS</u>	6
<u>DESCRIPTION OF DEBT SECURITIES</u>	7
<u>DESCRIPTION OF PIEDMONT OFFICE REALTY TRUST, INC. CAPITAL STOCK</u>	17
<u>CERTAIN PROVISIONS OF MARYLAND LAW AND PIEDMONT OFFICE REALTY TRUST, INC. S CHARTER AND BYLAWS</u>	21
<u>BOOK-ENTRY PROCEDURES AND SETTLEMENT</u>	27
<u>MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS</u>	28
<u>PLAN OF DISTRIBUTION</u>	49
<u>LEGAL MATTERS</u>	50
<u>EXPERTS</u>	50

Unless otherwise stated or the context otherwise requires, references in this prospectus to Piedmont, we, us and our refer, collectively, to Piedmont Office Realty Trust, Inc. and its consolidated subsidiaries, including Piedmont Operating Partnership, LP; the Company refers only to Piedmont Office Realty Trust, Inc. and not to any of its subsidiaries or affiliates; and the Operating Partnership refers only to Piedmont Operating Partnership, LP and not to its parent or subsidiaries or affiliates.

Table of Contents

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission (the SEC) using a shelf registration process. Under this shelf process, we may sell:

debt securities of the Operating Partnership, guaranteed by the Company,

common stock of the Company, and

preferred stock of the Company

in one or more offerings. This prospectus provides you with a general description of those securities. Each time we sell securities, we will provide a prospectus supplement and, if applicable, a pricing supplement that will contain specific information about the terms of that offering. The prospectus supplement and any pricing supplement may also add to, update or change information contained in this prospectus. You should carefully read this prospectus, any applicable prospectus supplement and any pricing supplement together with the additional information described under the heading **Where You Can Find More Information**.

The registration statement that contains this prospectus (including the exhibits to the registration statement) contains additional information about the Company and the Operating Partnership and the securities offered under this prospectus. That registration statement can be read at the SEC's web site or at the SEC's offices mentioned under the heading **Where You Can Find More Information**.

PIEDMONT OFFICE REALTY TRUST, INC. AND PIEDMONT OPERATING PARTNERSHIP, LP

Piedmont Office Realty Trust, Inc., or the Company, is a Maryland corporation that operates in a manner so as to qualify as a real estate investment trust (a REIT) for federal income tax purposes and engages in the acquisition and ownership of commercial real estate properties throughout the United States, including properties that are under construction, are newly constructed, or have operating histories. The Company was incorporated in 1997, commenced operations in 1998, and listed its common stock on the New York Stock Exchange in 2010. The Company conducts its business primarily through Piedmont Operating Partnership, LP, a Delaware limited partnership, or the Operating Partnership, and performs the management of its buildings through two wholly-owned subsidiaries, Piedmont Government Services, LLC and Piedmont Office Management, LLC. The Company is the sole general partner of the Operating Partnership and possesses full legal control and authority over its operations. The Operating Partnership is directly and indirectly 100% owned by the Company. The Operating Partnership owns properties directly, through wholly-owned subsidiaries and through both consolidated and unconsolidated joint ventures.

Our portfolio consists primarily of Class A commercial office buildings leased to large, credit-worthy, government and corporate tenants primarily in premier office markets such as Chicago, Washington, D.C., the New York metropolitan area, Boston and greater Los Angeles. For the past several years, we have been reducing the number of markets we operate within by selling non-strategic assets and recycling the proceeds into assets and markets which we believe have greater potential to contribute to enterprise value over time. Since 2005 we have exited 20 markets and plan to exit as many as seven additional markets over the next few years so that we are predominantly concentrated in ten of the largest U.S. office markets by year end 2015. As of March 31, 2013, we owned interests in 75 consolidated office properties, plus five buildings owned through unconsolidated joint ventures. Our 75 consolidated office properties are located in 17 metropolitan areas across the United States. These office properties comprise approximately 20.9 million square feet of primarily Class A commercial office space, and were approximately 86.0% leased as of March 31, 2013. As of March 31, 2013, we have a demonstrated capital allocation track record including transacting \$6.2 billion and \$1.7 billion in property acquisitions and dispositions, respectively, during our 15 year operating history.

Table of Contents

Our principal executive offices are located at 11695 Johns Creek Parkway, Suite 350, Johns Creek, Georgia 30097. Our main telephone number is (770) 418-8800. Our website is www.piedmontreit.com. Information contained on our website is not a part of this prospectus.

WHERE YOU CAN FIND MORE INFORMATION

The Company is subject to the information and periodic reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), and the Company files annual, quarterly and current reports and other information with the SEC. You can read the Company's SEC filings over the Internet at the SEC's website at www.sec.gov. To receive copies of public records not posted to the SEC's website at prescribed rates, you may complete an online form at <http://www.sec.gov>, send a fax to (202) 772-9337 or submit a written request to the SEC, Office of FOIA/PA Operations, 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information. The Company's SEC filings are also available in the investor relations portion of the Company's website at www.piedmontreit.com. The information on, or accessible through, our website is not part of this prospectus unless specifically incorporated herein by reference.

INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC allows us to incorporate by reference information in documents that have been filed with it. We have elected to use a similar procedure in connection with this prospectus and any prospectus supplement, which means that we can disclose important information about us by referring you to those documents that are considered part of this prospectus and any prospectus supplement. Any statement contained in this prospectus, any prospectus supplement or a document incorporated by reference in this prospectus or any prospectus supplement will be deemed to be modified or superseded for purposes of this prospectus or any prospectus supplement to the extent that a statement contained herein or therein, or in any other subsequently filed document that also is deemed to be incorporated herein or therein by reference, modifies or supersedes such statement. A statement so modified or superseded will not be deemed, except as so modified or superseded, to constitute a part of this prospectus or any prospectus supplement. We incorporate by reference the documents listed below that were filed by us with the SEC and any future filings made by us with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the time that we sell all the securities offered by this prospectus or any prospectus supplement; provided, however, that we are not incorporating by reference any information furnished (but not filed) under Item 2.02 or Item 7.01 of any Current Report on Form 8-K:

Annual Report on Form 10-K for the year ended December 31, 2012;

Quarterly Report on Form 10-Q for the quarter ended March 31, 2013;

Current Reports on Form 8-K filed on February 28, 2013, May 6, 2013, May 13, 2013 and June 4, 2013;

Definitive Proxy Statement for the Company's Annual Meeting of Stockholders to be held on May 22, 2013; and

the description of the Company's capital stock contained in the Company's Registration Statement on Form 8-A filed on February 5, 2010, including any amendment or report filed for the purpose of updating such description.

You may request a copy of these filings (other than an exhibit to a filing unless that exhibit is specifically incorporated by reference into that filing) at no cost, by writing to us at the following address:

Piedmont Office Realty Trust, Inc.

11695 Johns Creek Parkway, Suite 350

Johns Creek, Georgia 30097

Attention: Secretary

Table of Contents

You should rely only on the information incorporated by reference or provided in this prospectus, any prospectus supplement and any pricing supplement. We have not authorized anyone else to provide you with different information. We are not making an offer of these securities in any jurisdiction where the offer is not permitted. You should not assume that the information in this prospectus, any prospectus supplement or any pricing supplement is accurate as of any date other than the date on the front of the document and that any information we have incorporated by reference is accurate as of any date other than the date of the document incorporated by reference.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus and any prospectus supplement and the documents incorporated by reference herein and therein contain forward-looking statements within the meaning of the federal securities laws. In addition, we, or our executive officers on our behalf, may from time to time make forward-looking statements in reports and other documents that Piedmont files with the SEC or in connection with oral statements made to the press, potential investors or others. Statements regarding future events and developments and our future performance, as well as management's expectations, beliefs, plans, estimates, or projections relating to the future, are forward-looking statements within the meaning of these laws. Forward-looking statements include statements preceded by, followed by, or that include the words may, will, expect, intend, anticipate, estimate, believe, continue, or other similar words. These forward-looking statements are based on beliefs and assumptions of our management, which in turn are based on information available at the time the statements are made. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding the demand for office space in the sectors in which we operate, competitive conditions, and general economic conditions. These assumptions could prove inaccurate. The forward-looking statements also involve risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict. Such factors include, but are not limited to, the factors, including the risk factors discussed under Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2012, which has been incorporated into this prospectus by reference.

Table of Contents

RISK FACTORS

Investment in any securities offered pursuant to this prospectus involves risks. Before acquiring any offered securities pursuant to this prospectus, you should carefully consider the information contained or incorporated by reference in this prospectus or in any accompanying prospectus supplement, including, without limitation, the risk factors incorporated by reference to the Company's most recent Annual Report on Form 10-K, and the other information contained or incorporated by reference in this prospectus, as updated by the Company's subsequent filings under the Exchange Act, and the risk factors and other information contained in the applicable prospectus supplement before acquiring any of such securities. The occurrence of any of these risks might cause you to lose all or a part of your investment in the offered securities.

Table of Contents

USE OF PROCEEDS

Unless otherwise indicated in a prospectus supplement, we intend to use the net proceeds from the sale of any of our securities under this prospectus for general corporate purposes, including, but not limited to, working capital, investment in real estate and repayment of debt. Further details relating to the use of the net proceeds from the sale of securities under this prospectus will be set forth in the applicable prospectus supplement. Pending such uses, we anticipate that we will invest the net proceeds in interest-bearing accounts and short-term, interest-bearing securities in a manner consistent with the Company's intention to continue to qualify for taxation as a REIT.

Table of Contents

**RATIOS OF EARNINGS TO FIXED CHARGES AND
TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS**

The table below presents our ratio of earnings to fixed charges for each of the periods indicated:

	Years Ended December 31,					Three Months Ended March 31,	
	2012	2011	2010	2009	2008	2013	2012
Ratio of Earnings to Fixed Charges (1)	2.0	2.2	2.5	2.0	2.6	2.3	2.1

(1) For the three months ended March 31, 2013 and 2012 and the years ended December 31, 2012, 2011, 2010, 2009 and 2008 amounts have been adjusted to conform with the current period presentation, including classifying revenues from sold properties as discontinued operations for each such period.

We have computed the consolidated ratio of earnings to fixed charges by dividing earnings by fixed charges. Earnings consist of income from continuing operations less equity in income of unconsolidated joint ventures, plus operating distributions received from unconsolidated joint ventures, plus fixed charges, less preferred dividends of consolidated subsidiaries. Fixed charges consist of interest expense, including interest expense included in discontinued operations.

There was no preferred stock outstanding for any of the periods shown above. Accordingly, the ratio of earnings to combined fixed charges and preferred stock dividends was identical to the ratio of earnings to fixed charges for each period.

Table of Contents

DESCRIPTION OF DEBT SECURITIES

As used in this section, references to the Operating Partnership, we, our or us refer solely to Piedmont Operating Partnership, LP and not to any of its subsidiaries and references to the Company or guarantor refer solely to Piedmont Office Realty Trust, Inc. and not to any of its subsidiaries, unless otherwise expressly stated or the context otherwise requires.

This section describes the general terms and provisions of our debt securities. When we offer to sell a particular series of debt securities, we will describe the specific terms of the series in a supplement to this prospectus, along with any applicable modifications of or additions to the general terms of the debt securities as described in this prospectus, including the terms of any related guarantees by the Company. To the extent the information contained in the prospectus supplement differs from this summary description, you should rely on the information in the prospectus supplement.

The debt securities may be offered either separately, or together with, or upon the conversion or exercise of or in exchange for, other securities described in this prospectus. Debt securities will be the Operating Partnership's senior unsecured obligations and may be issued in one or more series.

Unless otherwise specified in a prospectus supplement, the debt securities will be issued under an indenture between the Company, the Operating Partnership and U.S. Bank National Association, as trustee. The indenture will contain the full legal text of the matters described in this section. We have summarized select portions of the indenture below. The summary is not complete and is subject to and qualified in its entirety by reference to all the provisions of the indenture, including definitions of the terms used in the indenture. Whenever we refer to particular sections or defined terms of the indenture in this prospectus or in a prospectus supplement, those sections or defined terms are incorporated by reference into this prospectus or the applicable prospectus supplement, and this summary also is subject to and qualified by reference to the description of the particular terms of a particular series of debt securities described in the applicable prospectus supplement. The form of the indenture has been filed as an exhibit to the registration statement and you should read the indenture for provisions that may be important to you. Capitalized terms used in the summary and not defined herein have the meanings specified in the indenture.

General

The terms of each series of debt securities will be established by or pursuant to a resolution of the Company's board of directors and set forth or determined in the manner provided in a resolution of the Company's board of directors, in an officer's certificate or by a supplemental indenture. The particular terms of each series of debt securities, along with any applicable modifications of or additions to the general terms of the debt securities as described in this prospectus, will be described in a prospectus supplement relating to such series (including any pricing supplement or term sheet). A prospectus supplement may change any of the terms of the debt securities described in this prospectus.

Unless we state otherwise in the applicable prospectus supplement, we can issue an unlimited amount of the debt securities under the indenture that may be in one or more series with the same or various maturities, at par, at a premium, or at a discount. We will set forth in a prospectus supplement (including any pricing supplement or term sheet) relating to any series of debt securities being offered, the aggregate principal amount and the following terms of the debt securities, if applicable:

the title of the debt securities;

the price or prices (expressed as a percentage of the principal amount) at which we will sell the debt securities;

any limit on the aggregate principal amount of the debt securities;

Table of Contents

the date or dates on which we will pay the principal of and premium, if any, on the debt securities;

the rate or rates (which may be fixed or variable) per annum or the method used to determine the rate or rates (including any commodity, commodity index, stock exchange index or financial index) at which the debt securities will bear interest, the date or dates from which interest will accrue, the date or dates on which interest will commence and be payable and any regular record date for the interest payable on any interest payment date;

the place or places where principal of, premium, if any, and interest on the debt securities will be payable;

the price or prices and the terms and conditions upon which we may redeem the debt securities;

any obligation we have to redeem or purchase the debt securities pursuant to any sinking fund or analogous provisions or at the option of a holder of debt securities;

the dates on which and the price or prices at which we will repurchase debt securities at the option of the holders of debt securities and other detailed terms and provisions of these repurchase obligations;

the denominations in which the debt securities will be issued, if other than denominations of \$2,000 and integral multiples of \$1,000 in excess thereof;

whether the debt securities will be issued in the form of certificated debt securities or global debt securities;

the portion of principal amount of the debt securities payable upon declaration of acceleration of the maturity date, if other than the principal amount;

the designation of the currency, currencies or currency units in which payment of principal of, premium and interest on the debt securities will be made and, if payments of principal, premium or interest on the debt securities will be made in one or more currencies or currency units other than that or those in which the debt securities are denominated, the manner in which the exchange rate with respect to these payments will be determined;

the manner in which the amounts of payment of principal of, premium, if any, or interest on the debt securities will be determined, if these amounts may be determined by reference to an index based on a currency or currencies other than that in which the debt securities are denominated or designated to be payable or by reference to a commodity, commodity index, stock exchange index or financial index;

any addition to, deletion of or change in the Events of Default described in this prospectus or in the indenture with respect to the debt securities and any change in the acceleration provisions described in this prospectus or in the indenture with respect to the debt securities;

any addition to, deletion of or change in the covenants described in this prospectus or in the indenture with respect to the debt securities;

any depositaries, interest rate calculation agents, exchange rate calculation agents or other agents with respect to the debt securities;
and

any other terms of the debt securities, which may supplement, modify or delete any provision of the indenture as it applies to that series.

As discussed above, we may issue debt securities that provide for an amount less than their stated principal amount to be due and payable upon declaration of acceleration of their maturity pursuant to the terms of the indenture. In addition, we may denominate the purchase price of any of the debt securities in a foreign currency or currencies or a foreign currency unit or units, and the principal of and any premium and interest on any series of debt securities may be payable in a foreign currency or currencies or a foreign currency unit or units. The applicable prospectus supplement will provide you with information on the federal income tax considerations and other special considerations applicable to any of the debt securities.

Table of Contents

No Protection in the Event of a Change of Control

Except to the extent described below under **Merger, Consolidation and Sale of Assets** or in the applicable prospectus supplement, the indenture will not prohibit the Operating Partnership or the Company or any of the Operating Partnership's or the Company's Subsidiaries from incurring additional indebtedness or issuing preferred equity in the future, nor will the indenture afford holders of any series of debt securities protection in the event of (1) a recapitalization or other highly leveraged or similar transaction involving the Operating Partnership or the Company, (2) a change of control of the Operating Partnership or the Company or (3) a merger, consolidation, reorganization, restructuring or transfer or lease of all or substantially all of the Operating Partnership's or the Company's assets or similar transactions that may adversely affect the holders of a series of debt securities.

Covenants

We will set forth in the applicable prospectus supplement any restrictive covenants applicable to any issue of any series of debt securities.

Ranking

The debt securities will be the Operating Partnership's senior unsecured obligations and will rank equally in right of payment with all the Operating Partnership's other existing and future senior unsecured indebtedness. The debt securities will be effectively subordinated in right of payment to:

all of the Operating Partnership's existing and future mortgage indebtedness and other secured indebtedness (to the extent of the value of the collateral securing such indebtedness); and

all existing and future indebtedness and other liabilities, whether secured or unsecured, of the Operating Partnership's subsidiaries.

Guarantee

The Company will fully and unconditionally guarantee the Operating Partnership's obligations under the debt securities, including the due and punctual payment of principal of and premium, if any, and interest on the debt securities, whether at stated maturity, upon acceleration, upon redemption or otherwise. Under the terms of the Company's guarantee, holders of the debt securities will not be required to exercise their remedies against the Operating Partnership before they proceed directly against the Company. The Company's obligations under the guarantee will be limited to the maximum amount that will not, after giving effect to all other contingent and fixed liabilities of the Company, result in the guarantee constituting a fraudulent transfer or conveyance. The guarantee will be a senior unsecured obligation of the Company and will rank equally in right of payment with all other existing and future senior unsecured indebtedness and guarantees of the Company. The Company's guarantee will be effectively subordinated in right of payment to:

all existing and future mortgage indebtedness and other secured indebtedness and secured guarantees of the Company (to the extent of the value of the collateral securing such indebtedness and guarantees); and

all existing and future indebtedness and other liabilities, whether secured or unsecured, of the Company's subsidiaries.

Merger, Consolidation and Sale of Assets

Unless we state otherwise in the applicable prospectus supplement, the Operating Partnership may not merge into or consolidate with or sell, lease, transfer, convey or otherwise dispose of its properties and assets substantially as an entirety to any Person or Persons unless:

the successor entity is a corporation organized and existing under the laws of the United States of America or any state or the District of Columbia;

Table of Contents

the successor corporation assumes by supplemental indenture all of the obligations of the Operating Partnership under the indenture;

immediately after giving effect to the transaction, no event of default and no event which, after notice or the lapse of time or both, would become an event of default, will have occurred and be continuing; and

an officer's certificate and opinion of counsel have been delivered to the trustee to the effect that the conditions set forth above have been satisfied.

Unless we state otherwise in the applicable prospectus supplement, the Company may not merge into or consolidate with or sell, lease, transfer, convey or otherwise dispose its properties substantially as an entirety to any Person or Persons unless:

the successor entity is a corporation organized and existing under the laws of the United States of America or any state or the District of Columbia;

the successor corporation assumes by supplemental indenture all of the Company's obligations under the indenture, including as guarantor;

immediately after giving effect to the transaction, no event of default and no event which, after notice or the lapse of time or both, would become an event of default, will have occurred and be continuing; and

an officer's certificate and an opinion of counsel have been delivered to the trustee to the effect that the conditions set forth have been satisfied.

The restrictions above shall not be applicable to the merger, amalgamation, arrangement or consolidation of the Operating Partnership or the Company with a Subsidiary of the Company if the Company's board of directors determines in good faith that the purpose of such transaction is principally to change the state of incorporation or convert the form of organization to another form.

In the case of any such merger, amalgamation, arrangement, consolidation, sale, transfer, conveyance or other disposition, but not a lease, in a transaction in which there is a successor entity, the successor entity will succeed to, and be substituted for, the Operating Partnership or the Company, as the case may be, under the indenture and, subject to the terms of the indenture, the Operating Partnership or the Company, as the case may be, will be released from its obligations under the indenture.

Person means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof, or any other entity or organization.

Subsidiary means, with respect to the Company or the Operating Partnership, (1) any Person, a majority of the outstanding voting stock, partnership interests, membership interests or other equity interest, as the case may be, of which is owned or controlled, directly or indirectly, by the Company or the Operating Partnership, as the case may be, or by one or more other Subsidiaries of the Company or the Operating Partnership, as the case may be, and (2) any other entity the accounts of which are consolidated with the Company's or the Operating Partnership's accounts, as the case may be. For the purposes of this definition, *voting stock* means stock having voting power for the election of directors, trustees or managers, as the case may be, whether at all times or only so long as no senior class of stock has such voting power by reason of any contingency.

Table of Contents

Events of Default

Unless we state otherwise in the applicable prospectus supplement, the following will be Events of Default with respect to any series of debt securities:

- (1) the failure to pay interest on the debt securities of such series when the same becomes due and payable, and the Default continues for a period of 30 days;
- (2) the failure to pay the principal (or premium, if any) of the debt securities of such series, when such principal (or premium, if any) becomes due and payable, at maturity, upon acceleration, upon redemption or otherwise;
- (3) a Default in the observance or performance of any other covenant or agreement contained in the indenture with respect to such series of debt securities, and the Default continues for a period of 60 days after the Operating Partnership receives written notice specifying the Default (and demanding that such Default be remedied) from the trustee or the holders of at least 25% of the outstanding principal amount of such series of debt securities;
- (4) default under any bond, debenture, note, mortgage, indenture or instrument under which there may be issued or by which there may be secured or evidenced any Debt of the Company, of the Operating Partnership or of any Subsidiary of the Company or the Operating Partnership, having an aggregate principal amount outstanding of at least \$50 million, whether such default shall have resulted in such indebtedness becoming or being declared due and payable prior to the date on which it would otherwise have become due and payable, without such indebtedness having been discharged, or such acceleration having been rescinded or annulled, within 60 days after written notice to the Operating Partnership by the trustee or holders of at least 25% in principal amount of the outstanding debt securities of such series; or

(5) certain events of bankruptcy or insolvency affecting the Company, the Operating Partnership or any other Significant Subsidiary. A supplemental indenture establishing the terms of a particular series of debt securities may delete, modify or add to the Events of Default described above.

If an Event of Default (other than an Event of Default specified in clause (5) above) with respect to the debt securities of a particular series shall occur and be continuing, the trustee or the holders of at least 25% of the principal amount of the debt securities of such series may declare the principal of, and accrued interest on, to be due and payable by notice in writing to the Operating Partnership and the trustee (if given by the holders) specifying the respective Event of Default and that it is a notice of acceleration, and the same shall become immediately due and payable.

Notwithstanding the foregoing, if an Event of Default specified in clause (5) above with respect to the debt securities of a particular series occurs and is continuing, then all unpaid principal of and premium, if any, and accrued and unpaid interest on the debt securities of such series shall automatically become and be immediately due and payable without any declaration or other act on the part of the trustee or any holder.

The indenture will provide that, at any time after a declaration of acceleration with respect to a series of debt securities as described in the preceding paragraph, the holders of a majority in principal amount of such series of debt securities may rescind and cancel such declaration and its consequences if:

the rescission would not conflict with any judgment or decree;

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all existing Events of Default have been cured or waived except nonpayment of principal or interest that has become due solely because of the acceleration;

to the extent the payment of such interest is lawful, interest on overdue installments of interest and overdue principal, which has become due otherwise than by such declaration of acceleration, has been paid; and

Table of Contents

the Operating Partnership has paid the trustee its reasonable compensation and reimbursed the trustee for its expenses, disbursements and advances.

No such rescission shall affect any subsequent Event of Default or impair any right consequent thereto.

Holders of a majority in principal amount of a series of affected debt securities may waive any existing Default or Event of Default and its consequences with respect to the series, except a Default (i) in the payment of the principal of or interest on the debt securities or (ii) in respect of a covenant or provision contained in the indenture that cannot be modified or amended without the consent of the holder of each debt security affected thereby.

The trustee will be required to give notice to the holders of an affected series of debt securities within 90 days of a default under the indenture unless the default has been cured or waived; provided, however, that the trustee may withhold notice to the holders of such series of debt securities of any default with respect to such series of debt securities (except a default in the payment of the principal of or premium, if any, or interest on the series of debt securities) if specified responsible officers of the trustee consider the withholding to be in the interest of the holders.

The indenture will provide that no holders of a series of debt securities may institute any proceedings, judicial or otherwise, with respect to the indenture or for any remedy thereunder, except in the case of failure of the trustee, for 60 days, to act after it has received a written request to institute proceedings in respect of an Event of Default with respect to such series of debt securities from the holders of not less than 25% in principal amount of the outstanding debt securities of such series, as well as an offer of reasonable indemnity and no direction inconsistent with that request has been given to the trustee by holders of a majority in aggregate principal amount of the outstanding debt securities of such series. This provision will not prevent, however, any holder of debt securities of a series from instituting suit for the enforcement of payment of the principal of or premium if any, or interest on the debt securities of such series on or after the respective due dates thereof.

Subject to provisions in the indenture relating to its duties in case of default, the trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any holders of any series of debt securities then outstanding under the indenture, unless the holders of such series of debt securities shall have offered to the trustee reasonable security or indemnity. The holders of not less than a majority in principal amount of the outstanding debt securities of a series shall have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee, or of exercising any trust or power conferred upon the trustee. However, the trustee may refuse to follow any direction which is in conflict with any law or the indenture or which may involve the trustee in personal liability or be unduly prejudicial to the holders of the debt securities of such series not joining therein.

The Operating Partnership will be required to provide an officers' certificate to the trustee promptly upon becoming aware of any Default or Event of Default, specifying such Default or Event of Default and further stating what action the Operating Partnership has taken, is taking or proposes to take with respect thereto. In addition, within 120 days after the close of each fiscal year, the Operating Partnership and the Company must deliver a certificate of an officer certifying to the trustee whether or not the officer has knowledge of any default under the indenture and, if so, specifying each default and the nature and status thereof.

Default means an event or condition the occurrence of which is, or with the lapse of time or the giving of notice or both would be, an Event of Default.

Significant Subsidiary means any Subsidiary that is a significant subsidiary within the meaning of Rule 1-02(w) of Regulation S-X under the Securities Act of 1933, as amended (the Securities Act).

Table of Contents

Modification of the Indenture

Unless we state otherwise in the applicable prospectus supplement, from time to time, the Operating Partnership, the Company and the trustee, without the consent of the holders of the affected series of debt securities, may amend the indenture and the terms of the affected series of debt securities for certain specified purposes, including:

to cure any ambiguity, defect or inconsistency;

to comply with the requirements of the SEC in order to effect or maintain the qualification of the indenture under the Trust Indenture Act of 1939, as amended (the "Trust Indenture Act");

to evidence and provide for the acceptance of appointment by a successor trustee;

to conform the terms of the indenture, the series of debt securities and/or the guarantee to this "Description of Debt Securities" and to the additional terms set forth in the applicable prospectus supplement;

to provide for the assumption by a successor corporation, partnership, trust or limited liability company of the Operating Partnership's or the Company's obligations under the indenture and the series of debt securities, in each case in compliance with the provisions thereof;

to comply with the rules of any applicable securities depository;

to make any change that would provide any additional rights or benefits to the holders of a series of debt securities (including to secure such series of debt securities, add guarantees with respect thereto, transfer any property to or with the trustee, add to the Operating Partnership's covenants for the benefit of the holders of such series of debt securities, add any additional events of default for such series of debt securities, or surrender any right or power conferred upon the Operating Partnership or the Company) or that does not adversely affect the legal rights hereunder of any holder of such series of debt securities in any respect; or

to supplement any provision of the indenture as shall be necessary to permit or facilitate the defeasance and discharge of such series of debt securities in accordance with the indenture; provided that such action shall not adversely affect the interests of any of the holders of such series of debt securities in any material respect.

In formulating its opinion on such matters, the trustee will be entitled to rely on such evidence as it deems appropriate, including, without limitation, solely on an opinion of counsel. Other modifications and amendments of the indenture may be made with the consent of the holders of a majority in principal amount of all then outstanding debt securities of the affected series, except that, without the consent of each holder of debt securities of the affected series, no amendment may:

reduce the above-stated percentage of outstanding debt securities of such series necessary to modify or amend the indenture, to waive compliance with certain provisions thereof or certain defaults and consequences thereunder or to change voting requirements set forth in the indenture;

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reduce the rate of, change or have the effect of changing the time for payment of interest, including defaulted interest, on such series of debt securities;

reduce the principal amount of, change or have the effect of changing the stated maturity of such series of debt securities, or change the date on which such series of debt securities may be subject to redemption or repurchase or reduce the redemption price or repurchase price therefor;

make such series of debt securities payable in currency other than that stated in such series of debt securities or change the place of payment of such series of debt securities from that stated in such series of debt securities or in the indenture;

Table of Contents

make any change in provisions of the indenture protecting the right of each holder of debt securities of such series to receive payment of principal of and interest on such series of debt securities on or after the due date thereof or to bring suit to enforce such payment, or permitting holders of a majority in principal amount of debt securities of such series to waive Defaults or Events of Default;

make any change to or modify in any manner adverse to the holders of debt securities of such series the terms and conditions of the obligations of the Company under the guarantee;

make any change to or modify the ranking of such series of debt securities that would adversely affect the holders thereof;

make any change in these amendment and waiver provisions; or

modify any of the foregoing provisions or any of the provisions relating to the waiver of certain past defaults or certain covenants, except to increase the required percentage to effect the action or to provide that certain other provisions may not be modified or waived without the consent of the holders of the debt securities of such series.

In determining whether the holders of the requisite principal amount of outstanding debt securities of a series have given any request, demand, authorization, direction, notice, consent or waiver thereunder, the indenture will provide that debt securities of such series owned by the Operating Partnership, the Company or any other obligor upon such series of debt securities or any affiliate of the Operating Partnership, the Company, or of the other obligor shall be disregarded.

Satisfaction, Discharge and Defeasance

The Operating Partnership and the Company may terminate their obligations under the indenture with respect to one or more series of debt securities, when:

either:

all the debt securities of such series that have been authenticated and delivered have been delivered to the trustee for cancellation; or

all the debt securities of such series issued that have not been delivered to the trustee for cancellation have become due and payable or will become due and payable at their stated maturity within one year (discharge) or are to be called for redemption on a redemption date within one year under arrangements satisfactory to the trustee for the giving of notice of redemption by such trustee in the Operating Partnership s name and at the Operating Partnership s expense, and the Operating Partnership has deposited or caused to be deposited with the trustee, in trust, sufficient funds to pay and discharge the entire indebtedness on such series of debt securities to pay principal (and premium, if any), interest and any additional amounts, to the date of such deposit (if the debt securities of such series have become due and payable) or to the maturity date or redemption date, as the case may be;

the Operating Partnership has paid or caused to be paid all other sums then due and payable under the indenture with respect to the debt securities of such series; and

the Operating Partnership has delivered to the trustee an officer s certificate and an opinion of counsel stating that all conditions precedent under the indenture relating to the satisfaction and discharge of the indenture with respect to the debt securities of such

series have been complied with.

Table of Contents

The Operating Partnership and the Company may elect to have their obligations under the indenture discharged with respect to the outstanding debt securities of one or more series (legal defeasance). Legal defeasance means that the Operating Partnership will be deemed to have paid and discharged the entire indebtedness represented by the outstanding debt securities of such series and to have satisfied all of its obligations under the debt securities of such series and the indenture with respect to such series of debt securities, except for:

the rights of holders of such series of debt securities to receive principal (and premium, if any), interest, if any, on such series of debt securities and any additional amounts when due;

the Operating Partnership's obligations with respect to such series of debt securities concerning the issuance of temporary debt securities; registration and transfer of debt securities; replacement of mutilated, destroyed, lost or stolen debt securities; compensation of the trustee from time to time for its services rendered under the indenture; maintenance of an office or agency for payment; and holding in trust sums sufficient for the payment of additional amounts, if any;

the rights, powers, trusts, duties and immunities of the trustee; and

the legal defeasance provisions of the indenture.

In addition, the Operating Partnership and the Company may elect to have their obligations released with respect to one or more series of debt securities with respect to certain covenants in the indenture (covenant defeasance). Any failure to comply with these obligations will not constitute an Event of Default with respect to such series of debt securities. In the event covenant defeasance occurs, certain events (not including non-payment, bankruptcy and insolvency events) described under Events of default will no longer constitute an event of default with respect to the debt securities of such series. Upon any legal defeasance (but not covenant defeasance) the Company will be released from its guarantee of the debt securities of such series.

In order to exercise either legal defeasance or covenant defeasance with respect to outstanding debt securities of a series:

the Operating Partnership or the Company must irrevocably have deposited or caused to be deposited with the trustee as trust funds for the purpose of making the following payments, specifically pledged as security for, and dedicated solely to the benefit of the holders of debt securities of such series:

money in dollars or in such foreign currency in which debt securities of such series are payable in at stated maturity;

non-callable U.S. government obligations; or

a combination of money and non-callable U.S. government obligations, in each case sufficient without reinvestment, in the written opinion of a nationally recognized firm of independent public accountants to pay and discharge, and which shall be applied by the trustee to pay and discharge, the principal of (and premium, if any) and interest on the outstanding debt securities of such series on the day on which such payments are due and payable in accordance with the terms of the indenture and of the debt securities of such series. Before such deposit, the Operating Partnership may make arrangements satisfactory to the trustee for the redemption of any debt securities of such series at a future date in accordance with any redemption provisions contained in any supplemental indenture relating to such series of debt securities, which shall be given effect in applying the foregoing;

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in the case of legal defeasance, the Operating Partnership has delivered to the trustee an opinion of counsel to the effect that (i) the Operating Partnership shall have received from, or there has been published by, the Internal Revenue Service a ruling, or (ii) since the date of the indenture there has been a change in the applicable federal income tax law, in either case to the effect that, and based thereon such opinion shall confirm that, the holders of debt securities of such series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of such legal defeasance and will

Table of Contents

be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such legal defeasance had not occurred;

in the case of covenant defeasance, the Operating Partnership has delivered to the trustee an opinion of counsel to the effect that the holders of debt securities of such series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of such covenant defeasance and will be subject to the same U.S. federal income tax as would be the case if the covenant defeasance had not occurred;

no Event of Default or event with which notice or lapse of time or both would become an Event of Default with respect to such series of debt securities has occurred and is continuing at the date of such deposit, or solely in the case of events of default due to certain events of bankruptcy, insolvency or reorganization, during the period ending on the 91st day after the date of, such deposit;

such legal defeasance or covenant defeasance will not cause the trustee to have a conflicting interest for the purposes of the Trust Indenture Act with respect to any of the Operating Partnership's or the Company's securities;

such legal defeasance or covenant defeasance will not result in a breach or violation of, or constitute a default under, the indenture or any other agreement or instrument to which the Operating Partnership or the Company are a party, or by which the Operating Partnership or the Company are bound;

such legal defeasance or covenant defeasance will not cause any securities listed on any registered national stock exchange under the Exchange Act to be delisted;

such legal defeasance or covenant defeasance will be effected in compliance with any additional terms, conditions or limitations which may be imposed on the Operating Partnership or the Company in connection therewith; and

the Operating Partnership has delivered to the trustee an officer's certificate and an opinion of counsel stating that all conditions precedent with respect to such legal defeasance or covenant defeasance have been complied with.

No Conversion Rights

The debt securities will not be convertible into or exchangeable for any capital stock of the Company or equity interest in the Operating Partnership.

Governing Law

The indenture, the debt securities and the guarantees endorsed on the debt securities will be governed by, and construed in accordance with, the internal laws of the State of New York.

Table of Contents

DESCRIPTION OF PIEDMONT OFFICE REALTY TRUST, INC. CAPITAL STOCK

We have summarized certain terms and provisions of the Company's common stock in this section. The summary is not complete. We have also filed the Company's charter and bylaws as exhibits to the registration statement. The rights of the Company's stockholders are also subject to Maryland law, under which the Company was incorporated. You should read the charter and bylaws for additional information before you buy any common stock.

As used in this section, references to we, our or us refer solely to Piedmont Office Realty Trust, Inc. and not to any of its subsidiaries, unless otherwise expressly stated or the context otherwise requires.

General

The following description of our capital stock is not complete, but is a summary of portions of our charter and is qualified in its entirety by reference to our charter. Under our charter, we have authority to issue a total of 1,000,000,000 shares of capital stock. Of the total shares authorized, 750,000,000 shares are designated as common stock with a par value of \$0.01 per share, 100,000,000 shares are designated as preferred stock, and 150,000,000 shares are designated as shares-in-trust, which would be issued only in the event that there is a purported transfer of, or other change in or affecting the ownership of, our capital stock that would result in a violation of the restrictions on ownership and transfer described below. As of March 31, 2013, (i) 167,555,401 shares of our common stock were issued and outstanding and (ii) no shares of preferred stock or shares-in-trust were issued and outstanding. Our board of directors, without any action on the part of our stockholders, may amend our charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have the authority to issue. Under Maryland law, stockholders generally are not liable for the corporation's debts or obligations.

Common Stock

Except as may otherwise be specified in the terms of any other class or series of common stock, the holders of common stock are entitled to one vote per share on all matters voted on by stockholders, including election of our directors. Our charter does not provide for cumulative voting in the election of directors. As such, the holders of a majority of the outstanding shares of our common stock can elect our entire board of directors, including all of the directors then standing for election, and the holders representing a minority of the outstanding shares of our common stock will be unable to elect any directors. Subject to any preferential rights of any outstanding class or series of preferred stock and to the distribution of specified amounts upon liquidation with respect to shares-in-trust, the holders of common stock are entitled to such distributions as may be authorized from time to time by our board of directors in its discretion and declared by us out of funds legally available therefor, and, upon liquidation, are entitled to receive all assets available for distribution to stockholders. Holders of shares of our common stock will neither have preemptive rights, which provide an automatic option to purchase any new shares that we issue, nor any appraisal rights.

Preferred Stock

Our charter authorizes our board of directors to designate and issue one or more classes or series of preferred stock without stockholder approval. Our board of directors may determine the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption of each class or series of preferred stock so issued, which may be more beneficial than the rights, preferences and privileges attributable to the common stock. No shares of our preferred stock are presently outstanding. Our board of directors may issue preferred stock at any time in the future without stockholder approval. If the board of directors approves the issuance of preferred stock, such issuance could, depending upon the terms of such class or series, delay, defer or prevent a transaction or a change in control of us that might involve a premium price for holders of our common stock or otherwise be in their best interests.

Table of Contents

Power to Reclassify Shares of Our Stock

Subject to the provisions of any outstanding shares of capital stock, our charter authorizes our board of directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including our preferred stock. Prior to issuance of shares of each class or series, our board of directors is required by Maryland law and by our charter to set, subject to restrictions on the transfer and ownership of our stock contained in our charter, the terms of such class or series, including the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series.

Power to Issue Additional Shares of Common Stock and Preferred Stock

Our board of directors has the power, without stockholder approval, to amend our charter from time to time to increase or decrease the aggregate number of authorized shares of capital stock or the number of shares of any class or series that we have authority to issue. We believe that these powers, together with the power to issue additional authorized but unissued shares of our common stock or preferred stock and the power to classify or reclassify any unissued shares of stock into other classes or series of stock, will provide us with increased flexibility in structuring possible future financings and acquisitions and in meeting other capital needs. The additional classes or series, as well as our common stock, will be available for issuance without further action by our stockholders unless stockholder action is required by applicable law or the rules of any national securities exchange on which our securities may be listed or traded.

Restrictions on Ownership and Transfer

In order for us to qualify as a REIT, during the last half of each taxable year, not more than 50% of the value of our outstanding shares may be owned, directly or indirectly, by five or fewer individuals, as defined in the Internal Revenue Code of 1986, as amended (the Code), to include certain entities. In addition, the outstanding shares must be beneficially owned by 100 or more persons during at least 335 days of a 12-month taxable year or during a proportionate part of a shorter taxable year. We may prohibit certain acquisitions and transfers of shares so as to ensure our continued qualification as a REIT under the Code. However, we cannot assure you that this prohibition will be effective.

In order to assist us in preserving our status as a REIT, among other purposes, our charter generally prohibits any person (unless exempted by our board of directors) from actually or constructively owning more than 9.8% (by value or number of shares, whichever is more restrictive) of the outstanding shares of our common stock or the outstanding shares of any class or series of our preferred stock. Our charter further prohibits any person from (a) transferring shares of our stock if the transfer would result in our stock being actually owned by fewer than 100 persons or (b) actually or constructively owning shares of our stock that would result in our (i) being closely held under Section 856(h) of the Code, (ii) constructively owning 9.9% or more of the ownership interests in any of our tenants or any tenant of the Operating Partnership or any of our direct or indirect subsidiaries or (iii) otherwise failing to qualify as a REIT. Our board of directors may, prospectively or retroactively, exempt a person from the 9.8% ownership limit upon receipt of evidence deemed satisfactory by it, in its sole discretion, that a proposed acquisition or transfer will not result in our being closely held under Section 856(h) of the Code or otherwise failing to qualify as a REIT.

Any transfer of shares of our stock that, if effective, would result in a violation of any of the foregoing restrictions on ownership and transfer of our stock will be null and void and the intended transferee will acquire no rights in such shares. However, if there is a transfer of shares of our stock in violation of any of the foregoing restrictions, the number of shares causing the violation (rounded up to the next whole number of shares) will be automatically converted into an equal number of shares-in-trust having terms, rights, restrictions and qualifications identical thereto, except to the extent our charter requires different terms, and will be transferred to a trust for the exclusive benefit of one or more charitable beneficiaries. The transfer to the trust will be effective as of the close of business on the business day preceding the date of the violative transfer. We will designate a

Table of Contents

trustee of the share trust that will not be affiliated with us. We will also name one or more charitable organizations as a beneficiary of the share trust. Shares-in-trust will remain issued and outstanding shares and will be entitled to the same rights and privileges as all other shares of the same class or series. The trustee will receive all dividends and other distributions on the shares-in-trust and will hold such dividends or other distributions in trust for the benefit of the beneficiary. The trustee may vote any shares held in trust.

Any dividend or other distribution with a record date on or after the date shares of our stock were converted to shares-in-trust which is paid to the intended transferee will be repaid to the share trust and any dividend or other distribution declared but unpaid will be paid to the trustee to hold in trust for the benefit of the beneficiary. We will take all measures that we determine are necessary to recover the amount of any dividend or other distribution paid to the intended transferee, including, if necessary, withholding any portion of future dividends or other distributions payable on shares of our stock owned by the intended transferee and, as soon as reasonably practicable thereafter, paying to the share trust for the benefit of the beneficiary the dividends or other distributions so withheld. The trustee will be entitled to vote the shares-in-trust on any matters on which holders of shares of the same class or series are entitled to vote. Subject to Maryland law, any vote cast by the intended transferee prior to our discovery that shares have been converted into shares-in-trust will be rescinded and recast by the trustee in its sole and absolute discretion. However, if we have already taken irreversible corporate action, then the trustee will not have the authority to rescind and recast the vote.

Shares-in-trust will be deemed to have been offered for sale to us, or our designee, at a price per share equal to the lesser of (i) the price per share in the transaction that created the shares-in-trust (or, in the case of a devise or gift, the market price at the time of the devise or gift) and (ii) the market price on the date we, or our designee, accept the offer. We will have the right to accept the offer for a period of 20 days after the later of the date of the transaction resulting in the conversion of shares of our stock into shares-in-trust or, if we did not receive notice of the transaction, the date that we determine in good faith that such transaction occurred.

If we do not purchase the shares-in-trust, the trustee will sell the number of shares represented by the shares-in-trust to a person designated by the trustee, whose ownership of the shares will not violate the above restrictions on ownership and transfer of our stock. Within five business days after the closing of the sale, the intended transferee will receive the lesser of (i) the price per share in the transaction that created the shares-in-trust (or, in the case of a devise or gift, the market price on the date of such transfer) and (ii) the price per share received by the trustee net of any commissions and other expenses of the sale. Any amount received by the trustee in excess of the amount paid to the intended transferee will be distributed to the beneficiary.

Any person who (1) acquires shares in violation of the foregoing restrictions or who owns shares that were transferred to any such trust is required to give immediate written notice to us of such event and (2) any person who proposes or attempts to transfer or own such shares is required to give us 15 days written notice prior to such transaction.

In both cases, such persons shall provide to us such other information as we may request in order to determine the effect, if any, of such transfer on our status as a REIT.

The foregoing restrictions will continue to apply until our board of directors determines it is no longer in our best interest to continue to qualify as a REIT or that compliance is no longer required for REIT qualification. The restrictions on ownership and transfer of our stock generally do not apply to the underwriter in a public offering of shares for a period of 60 days following the initial purchase by the underwriter of shares in the offering.

Any person who owns more than 5% (or such lower percentage as determined pursuant to regulations under the Code or as may be requested by our board of directors in its sole discretion) of our outstanding shares during any taxable year must give us written notice setting forth such person's name and address, the number of shares beneficially owned, directly or indirectly, and a description of how such shares are held. Each such owner must provide us with such additional information as we may request in order to determine the effect, if any, of such person's beneficial ownership on our status as a REIT and to ensure compliance with the ownership limits and

Table of Contents

other restrictions on ownership and transfer of stock set forth in our charter. In addition, each stockholder must promptly provide us with such information as we may request in order to determine our status as a REIT and to comply with the requirements of any taxing authority or other governmental agency or to determine such compliance.

Meetings, Voting Requirements and Access to Records

An annual meeting of our stockholders will be held each year. Special meetings of stockholders may be called by our board of directors, the chairman of our board, the chief executive officer or the president and must be called, subject to the satisfaction of certain procedural and information requirements by the stockholders requesting the meeting, by our secretary upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast on any matter that may properly be considered at such meeting. The presence either in person or by proxy of stockholders entitled to cast 50% of all the votes entitled to be cast at such meeting on any matter shall constitute a quorum. Generally, a majority of the votes cast is necessary to take stockholder action at a meeting at which a quorum is present, except that a plurality of the votes cast at a meeting of stockholders duly called and at which a quorum is present is sufficient to elect a director and except for those matters described in Certain Provisions of Maryland Law and Piedmont Office Realty Trust, Inc.'s Charter and Bylaws Removal of Directors and Approval of Extraordinary Corporate Action; Amendment of Charter and Bylaws.

Stockholders have rights under Rule 14a-7 under the Exchange Act which provides that, upon the request of investors and the payment of the expenses of the distribution, we are required to distribute specific materials to stockholders in the context of the solicitation of proxies for voting on matters presented to stockholders or, at our option, provide requesting stockholders with a copy of a list of our stockholders so that the requesting stockholders may make the distribution of proxies themselves. The list provided by us will include each stockholder's name and address and the number of shares owned by each stockholder and will be sent within five business days of the receipt by us of the request.

Listing

Our common stock is listed on the NYSE under the symbol PDM.

Transfer Agent and Registrar

Computershare, Inc. serves as the transfer agent and registrar for the common stock.

Table of Contents

CERTAIN PROVISIONS OF MARYLAND LAW AND PIEDMONT OFFICE REALTY TRUST, INC. S CHARTER AND BYLAWS

The following description of the terms of the Company's stock and of certain provisions of Maryland law is only a summary. For a complete description, we refer you to the applicable Maryland law and to our charter and bylaws, copies of which are filed as exhibits to the registration statement.

As used in this section, references to we, our or us refer solely to Piedmont Office Realty Trust, Inc. and not to any of its subsidiaries, unless otherwise expressly stated or the context otherwise requires.

Number of Directors; Vacancies

Our charter provides that the number of directors will be set by our board of directors pursuant to our bylaws, provided that the number is not fewer than the minimum number required by the Maryland General Corporation Law (the "MGCL"). Our bylaws provide that a majority of our entire board of directors may, at any time, increase or decrease the number of directors, provided that the number is not fewer than the minimum number required by the MGCL nor more than 15. In addition, our bylaws provide that any vacancy, including a vacancy created by an increase in the number of directors, will be filled by a majority of the remaining directors, even if the remaining directors do not constitute a quorum. Any director elected to fill a vacancy will serve until the next annual meeting of stockholders and until a successor is duly elected and qualifies.

Removal of Directors

Our charter provides that, subject to the rights of holders of one or more classes or series of preferred stock to elect or remove one or more directors, a director may be removed only for cause (as defined in our charter) and only by the affirmative vote of at least two-thirds of the votes entitled to be cast generally in the election of directors. This provision, when coupled with the power of our board of directors to fill vacant directorships, precludes stockholders from removing incumbent directors and filling the vacancies created by such removal with their own nominees, except upon the existence of cause for removal and a substantial affirmative vote.

Action by Stockholders

Under the MGCL, stockholder action can be taken only at an annual or special meeting of stockholders or by unanimous consent in lieu of a meeting (unless the charter provides for a lesser percentage, which our charter does not). Special meetings of stockholders may be called by our board of directors, the chairman of our board, the chief executive officer or the president, and must be called, subject to the satisfaction of certain procedural and information requirements by the stockholders requesting the meeting, by our secretary upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast on any matter that may properly be considered at such meeting. These provisions, combined with the advance notice provisions of our bylaws, which are set forth below, may have the effect of delaying consideration of a stockholder proposal until the next annual meeting.

Advance Notice Provisions for Stockholder Nominations and Stockholder Proposals

Our bylaws provide that:

with respect to an annual meeting of stockholders, nominations of individuals for election to our board of directors and the proposal of business to be considered by stockholders may be made only:

pursuant to our notice of the meeting;

by or at the direction of our board of directors; or

by a stockholder who was a stockholder of record both at the time of giving of notice by such stockholder as required by our bylaws and at the time of the annual meeting, who is entitled to

Table of Contents

vote at the meeting in the election of each individual so nominated or any such other business and who has complied with the advance notice procedures of our bylaws; and

with respect to special meetings of stockholders, only the business specified in our notice of the meeting may be conducted at the meeting. Nominations of individuals for election to our board of directors at a special meeting at which directors are to be elected may be made only:

by or at the direction of our board of directors;

by a stockholder that has requested that a special meeting be called for the purpose of electing directors in compliance with our bylaws and that has supplied the information required by our bylaws about each individual whom the stockholder proposes to nominate for election as a director; or

provided that the special meeting has been called by our board of directors, the chairman of our board, the chief executive officer or the president for the purpose of electing directors, by a stockholder who was a stockholder of record both at the time of giving of notice by such stockholder as required by our bylaws and at the time of the special meeting, who is entitled to vote at the meeting in the election of each individual so nominated and who has complied with the advance notice provisions of our bylaws.

Generally, under our bylaws, a stockholder seeking to nominate a director or bring other business before our annual meeting of stockholders must deliver a notice to our secretary not earlier than the 150th day nor later than 5:00 p.m., Eastern Time, on the 120th day prior to the first anniversary of the release of the proxy statement for the prior year's annual meeting. For a stockholder seeking to nominate a candidate for election or re-election to our board of directors, the notice must describe various matters regarding the nominee, including name, address, occupation and number of shares held, and other specified matters. For a stockholder seeking to propose other business, the notice must include a description of the proposed business, the reasons for the proposal and other specified matters. In each case the notice must include the name and address of and number of shares owned by the stockholder.

The purpose of requiring stockholders to give us advance notice of nominations and other business is to afford our board of directors a meaningful opportunity to consider the qualifications of the proposed nominees and the advisability of any other proposed business and, to the extent deemed necessary or desirable by our board of directors, to inform stockholders and make recommendations about such qualifications or business, as well as to provide a more orderly procedure for conducting meetings of stockholders. Although our bylaws do not give our board of directors any power to disapprove stockholder nominations for the election of directors or proposals recommending certain action, they may have the effect of precluding a contest for the election of directors or the consideration of stockholder proposals if proper procedures are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its own proposal without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our stockholders.

Approval of Extraordinary Corporate Action; Amendment of Charter and Bylaws

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, effect certain mergers, sell all or substantially all of its assets, engage in a share exchange or engage in a similar transaction outside the ordinary course of business unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter, with certain exceptions, generally provides for approval of charter amendments and extraordinary transactions (which have been first declared advisable by our board of directors) by the stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter.

Table of Contents

Our bylaws provide that our board of directors will have the exclusive power to adopt, alter or repeal any provision of our bylaws and to make new bylaws.

No Appraisal Rights

As permitted by the MGCL, our charter provides that stockholders will not be entitled to exercise appraisal rights unless a majority of our board of directors determines that such rights will apply with respect to all or any classes or series of stock classified or reclassified in the future.

Control Share Acquisitions

The Maryland Control Share Acquisition Act provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter. Shares beneficially owned by the acquiring person, by officers or by employees who are directors of the corporation are excluded from the vote on whether to accord voting rights to control shares. Control shares are voting shares which, if aggregated with all other shares previously acquired by the acquiring person, or in respect of which the acquiring person has the right to vote or to direct the voting of, other than solely by virtue of revocable proxy, would entitle the acquiring person to exercise voting power in electing directors within one of the following ranges of voting powers:

one-tenth or more but less than one-third;

one-third or more but less than a majority; or

a majority or more of all voting power.

Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. Except as otherwise specified in the statute, a control share acquisition means the acquisition of issued and outstanding control shares.

Once a person who has made or proposes to make a control share acquisition has undertaken to pay expenses and has satisfied other required conditions, the person may compel our board of directors to call a special meeting of stockholders, to be held within 50 days of demand, for the purpose of considering the voting rights of such shares. If no request for a meeting is made, we may present the question at any stockholders meeting.

If voting rights are not approved for the control shares at the meeting or if the acquiring person does not deliver an acquiring person statement for the control shares as required by the statute, we may repurchase any or all of the control shares for their fair value, except for control shares for which voting rights have previously been approved. Fair value is determined without regard to the absence of voting rights for the control shares and as of the date of the last control share acquisition or of any meeting of stockholders at which the voting rights of the shares were considered and not approved.

If voting rights for control shares are approved at a stockholders meeting and the acquiring person becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of these appraisal rights may not be less than the highest price per share paid in the control share acquisition. Some of the limitations and restrictions otherwise applicable to the exercise of appraisal rights do not apply in the context of a control share acquisition.

The control share acquisition statute does not apply to:

shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction; or

acquisitions approved or exempted by the charter or bylaws of the corporation.

Table of Contents

Our bylaws contain a provision exempting from the Control Share Acquisition Act any and all acquisitions by any person of shares of our stock. We can provide no assurance that our board of directors will not amend or eliminate such provision at any time in the future.

Business Combinations

The MGCL prohibits business combinations between a Maryland corporation and an interested stockholder or the interested stockholder's affiliate for five years after the most recent date on which the stockholder becomes an interested stockholder. For this purpose, the term business combinations includes mergers, consolidations, share exchanges, or, in circumstances specified in the MGCL, asset transfers and issuances or reclassifications of equity securities. An interested stockholder is defined for this purpose as:

any person who beneficially owns 10% or more of the voting power of our outstanding voting stock; or

an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then outstanding stock.

A person is not an interested stockholder under the MGCL if our board of directors approved in advance the transaction by which he or she otherwise would have become an interested stockholder. However, in approving a transaction, our board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by our board of directors.

After the five-year prohibition, any business combination between us and an interested stockholder generally must be recommended by our board of directors and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of our then outstanding voting stock; and

two-thirds of the votes entitled to be cast by holders of our voting stock other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or shares held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if our common stockholders receive a minimum price, as defined under the MGCL, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by our board of directors before the time that the interested stockholder becomes an interested stockholder. Our board of directors has adopted a resolution which provides that any business combination between us and any other person is exempted from the provisions of the Business Combination Act. However, our board of directors may, by resolution, opt into the business combination statute in the future. We can provide no assurance that our board of directors will not opt back into the provisions of this law. Should our board opt into the business combination statute or fail to first approve a business combination, the business combination statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Other Anti-Takeover Provisions of Maryland Law

Subtitle 8 of Title 3 of the MGCL permits a Maryland corporation with a class of equity securities registered under the Exchange Act and at least three independent directors to elect to be subject, by provision in its charter or bylaws or a resolution of its board of directors and notwithstanding any contrary provision in the charter or bylaws, to any or all of five provisions:

a classified board;

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a two-thirds stockholder vote requirement for removing a director;

a requirement that the number of directors be fixed only by vote of the directors;

Table of Contents

a requirement that a vacancy on the board be filled only by the remaining directors and for the remainder of the full term of the class of directors in which the vacancy occurred; and

a majority requirement for the calling of a special meeting of stockholders.

Through provisions in our charter and our bylaws unrelated to Subtitle 8, we already (a) require a two-thirds stockholder vote for the removal of any director from the board, as well as require that such removal be for cause (as defined in our charter), (b) vest in the board the exclusive power to fix the number of directorships, (c) allow most vacancies on the board of directors to be filled only by the remaining directors and (d) unless called by the chairman of our board, our chief executive officer, our president or the board, require the request of stockholders entitled to cast a majority of all votes entitled to be cast on any matter that may properly be considered at a special meeting to call such a meeting.

Ownership Limit

Our charter generally prohibits any person (unless exempted prospectively or retroactively by our board of directors) from actually or constructively owning more than 9.8% (by value or number of shares, whichever is more restrictive) of the outstanding shares of our common stock or the outstanding shares of any class or series of our preferred stock. For more information regarding these restrictions, see Description of Capital Stock Restrictions on Ownership and Transfer. We have committed not to use the ownership limit contained in our charter as an anti-takeover device.

Indemnification and Limitation of Liability

Maryland law permits us to include in our charter a provision limiting the liability of our directors and officers to us and our stockholders for money damages, except for liability resulting from (1) actual receipt of an improper benefit or profit in money, property or services or (2) active and deliberate dishonesty established by a final judgment and that is material to the cause of action. Our charter contains a provision that eliminates directors' and officers' liability to the maximum extent permitted by Maryland law.

Maryland law requires us (unless our charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made or threatened to be made a party by reason of his or her service in that capacity. Maryland law permits us to indemnify our present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made or threatened to be made a party by reason of their service in those or other capacities unless it is established that:

the act or omission of the director or officer was material to the matter giving rise to the proceeding and (1) was committed in bad faith or (2) was the result of active and deliberate dishonesty;

the director or officer actually received an improper personal benefit in money, property or services; or

in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. A court may order indemnification if it determines that the director or officer is fairly and reasonably entitled to indemnification, even though the director or officer did not meet the prescribed standard of conduct or was adjudged liable on the basis that personal benefit was improperly received. However, indemnification for an adverse judgment in a suit by us or in our right, or for a judgment of liability on the basis that personal benefit was improperly received, is limited to expenses.

In addition, Maryland law permits us to advance reasonable expenses to a director or officer upon receipt by us of (1) a written affirmation by the director or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification and (2) a written undertaking by such person or on such person's behalf to repay the amount paid or reimbursed if it is ultimately determined that the standard of conduct was not met.

Table of Contents

Our charter and bylaws obligate us, to the maximum extent permitted by Maryland law, to indemnify (1) any present or former director or officer or (2) any individual who, while a director or officer and, at our request, serves or has served another corporation, REIT, partnership, limited liability company, joint venture, trust, employee benefit plan or other enterprise as a director, officer, partner, member, manager or trustee, against any claim or liability arising from his or her service in that capacity and to pay or reimburse such individual's reasonable expenses in advance of final disposition of a proceeding.

Our board believes that these provisions will facilitate our ability to attract and retain qualified director and officer candidates and may aid in our obtaining director and officer liability insurance and controlling insurance costs. We believe that provisions of this nature are similar to the provisions provided by many other publicly traded companies and, thus, will allow us to compete with those companies for the most qualified candidates.

Possible Anti-Takeover Effect of Certain Provisions of Maryland Law and of Our Charter and Bylaws

The business combination provisions of Maryland law (if our board of directors opts into the business combination statute or fails to first approve a business combination), the control share acquisition provisions of Maryland law (if the applicable provision in our bylaws is rescinded), the provisions of our charter relating to removal of directors, restrictions on ownership and transfer of our stock and the board's power to issue additional shares of common stock or preferred stock and the advance notice provisions of our bylaws could have the effect of delaying, deterring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interests. However, these provisions may also discourage certain coercive takeover practices and inadequate takeover bids and encourage persons seeking to acquire control of us to negotiate first with our board of directors. We believe that the benefits of these provisions outweigh the potential disadvantages of discouraging any such acquisition proposals because, among other things, the negotiation of such proposals may improve their terms. However, we have committed not to use the ownership limit contained in our charter as an anti-takeover device.

Table of Contents

BOOK-ENTRY PROCEDURES AND SETTLEMENT

We can issue the securities covered by this prospectus in definitive form or in the form of one or more global securities. The applicable prospectus supplement will describe the manner in which the securities offered thereby will be issued.

Table of Contents

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

General

The following discussion describes the material U.S. federal income tax considerations relating to the Company's treatment as a REIT under the Code, and relating to the acquisition, ownership and disposition of shares of the Company's common stock. If the Company offers equity securities other than common stock (such as preferred stock or depository shares), if the Operating Partnership offers debt securities, or if any selling security holder sells such securities, information about any additional federal income tax consequences to holders of those securities will be included in the applicable prospectus supplements. Because this is only a summary, it may not contain all of the information that may be important in your specific circumstances. As you review this discussion, you should keep in mind that:

- (1) The tax considerations to you may vary depending on your particular tax situation;
- (2) Special rules that are not discussed below may apply to you if, for example, you are a tax-exempt organization, a broker-dealer, a non-U.S. person, a trust, an estate, a regulated investment company, a financial institution, an insurance company, or otherwise subject to special tax treatment under the Code;
- (3) This summary does not address state, local or non-U.S. tax considerations;
- (4) This summary deals only with persons who hold shares of the Company's common stock as "capital assets" within the meaning of Section 1221 of the Code; and
- (5) This discussion is not intended to be, and should not be construed as, tax advice.

You are urged both to review the following discussion and to consult with an independent tax advisor to determine the effect of acquiring, owning and disposing of shares of the Company's common stock in your individual tax situation, including any state, local or non-U.S. tax consequences.

The information in this section is based on the Code, final, temporary and proposed regulations promulgated by the U.S. Treasury Department, the legislative history of the Code, current administrative interpretations and practices of the Internal Revenue Service, referred to in this prospectus as the IRS, and judicial decisions. The reference to IRS interpretations and practices includes IRS practices and policies reflected in private letter rulings, which are not binding on the IRS except with respect to the taxpayer that received the ruling. In each case, these sources are relied on as they exist on the date of this prospectus. Future legislation, regulations, administrative interpretations and judicial decisions could change current law or adversely affect existing interpretations of current law. Any change could apply retroactively.

Taxation of the Company

The Company elected to be taxable as a REIT commencing with its taxable year ending December 31, 1998. The Company has received the opinion of King & Spalding LLP that, commencing with such taxable year and continuing through its taxable year ended December 31, 2012, the Company has been organized and has operated in conformity with the requirements for qualification and taxation as a REIT under the Code, and its current organization and method of operation will enable it to continue to meet the requirements for qualification and taxation as a REIT. It must be emphasized that the opinion of King & Spalding LLP is based on various assumptions relating to the organization and operation of the Company. It is also conditioned upon factual representations and covenants made by the Company regarding its organization, assets and the past, present and future conduct of its business operations. While the Company intends to operate so that it will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in the Company's circumstances, no assurance can be given by King & Spalding LLP or by the Company that it will so qualify for any particular year. King & Spalding LLP has no obligation to advise the Company or the holders of the Company's common stock of any subsequent change in

Table of Contents

the matters stated, represented or assumed in the opinion, or of any subsequent change in the applicable law. You should be aware that opinions of counsel are not binding on the IRS or any court, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinion.

If the Company qualifies for taxation as a REIT, it generally will not be subject to federal corporate income taxes on that portion of its ordinary income or capital gain that it distributes currently to its stockholders, because the REIT provisions of the Code generally allow a REIT to deduct dividends paid to its stockholders. This substantially eliminates the federal double taxation on earnings (taxation at both the corporate level and stockholder level) that usually results from an investment in a non-REIT C corporation. However, stockholders who are taxed at individual rates generally are taxed on dividends they receive from non-REIT C corporations at capital gains rates, whereas REIT dividends that are not designated as capital gain dividends are taxed at the higher ordinary income rates. In addition, stockholders who are taxed at regular corporate rates will receive the benefit of a dividends received deduction on dividends from non-REIT C corporations that substantially reduces the effective rate that they pay on such dividends, whereas no such deduction is allowable with respect to REIT dividends. Still, income earned by a REIT and distributed currently to its stockholders generally will be subject to lower aggregate rates of federal income taxation than if such were earned by a non-REIT C corporation, subjected to corporate income tax, and then distributed to stockholders and subjected to tax either at capital gains rates or the effective rate paid by a corporate recipient entitled to the benefit of the dividends received deduction.

Even if the Company qualifies for taxation as a REIT, it will be subject to federal income taxation as follows:

The Company will be taxed at regular corporate rates on any undistributed REIT taxable income, including undistributed net capital gain.

The Company may be subject to the alternative minimum tax on its undistributed items of tax preference, if any, under certain circumstances.

If the Company has (a) net income from the sale or other disposition of foreclosure property that is held primarily for sale to customers in the ordinary course of business or (b) other non-qualifying income from foreclosure property, the Company will be subject to tax at the highest corporate tax rate on such income.

The Company's net income from prohibited transactions will be subject to a 100% penalty tax. In general, prohibited transactions are sales or other dispositions of property (other than foreclosure property) held as inventory or otherwise primarily for sale to customers in the ordinary course of business.

If the Company fails to satisfy either the 75% gross income test or the 95% gross income test discussed below, but nonetheless maintains qualification as a REIT because other requirements are met, the Company will be subject to a tax equal to the gross income attributable to (1) the greater of either (a) the amount by which 75% of its gross income exceeds the amount qualifying under the 75% gross income test for the taxable year or (b) the amount by which 95% of its gross income (90% for taxable years beginning before October 23, 2004) exceeds the amount of its income qualifying for the 95% gross income test for the taxable year, multiplied in either case by (2) a fraction intended to reflect the Company's profitability.

The Company will be subject to a 4% nondeductible excise tax on the excess of the required distribution for the calendar year (as described below) over the sum of amounts actually distributed in such calendar year, excess distributions from the preceding calendar year, and undistributed income on which the Company paid federal income tax. The required distribution for each calendar year is equal to the sum of:

85% of the Company's REIT ordinary income for the year,

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95% of the Company's REIT capital gain net income for such year, and

Table of Contents

any undistributed taxable income from prior taxable years.

The Company will be subject to a 100% penalty tax on some payments received from tenants or from the Company's taxable REIT subsidiaries, or on certain expenses deducted by the Company's taxable REIT subsidiaries, if arrangements involving the Company's taxable REIT subsidiaries are not comparable to similar arrangements among unrelated parties.

If the Company acquires any assets from a regular C corporation in a transaction in which the basis of the assets in the Company's hands is determined by reference to the basis of the assets (or any other property) in the hands of the C corporation, the Company would have to pay corporate income tax, at the highest applicable corporate rate, on the built-in gain with respect to those assets if the Company were to dispose of those assets within 10 years after acquiring them. Built-in gain is the amount by which an asset's fair market value exceeds its adjusted tax basis at the time the Company acquires the asset. The assets the Company acquired in a 2007 internalization transaction are subject to the tax on built-in gains if the Company is treated as having disposed of them in a taxable transaction during the applicable ten-year recognition period beginning on the date the transaction was consummated (under a special temporary relief provision enacted by Congress as an amendment to Section 1374 of the Code, sales of such assets that occur in 2013 may not be subject to the Built-in Gains Tax).

If the Company fails to satisfy one of the REIT asset tests (other than certain de minimis failures), but nonetheless maintains its qualification as a REIT because other requirements are met, the Company will be subject to a tax equal to the greater of \$50,000 or the amount determined by multiplying the net income generated by the non-qualifying assets during the period of time that the Company held the assets as non-qualifying assets by the highest rate of tax applicable to corporations.

If the Company fails to satisfy certain of the REIT qualification requirements under the Code (other than the gross income and asset tests), and the failure is due to reasonable cause and not willful neglect, the Company may be required to pay a penalty of \$50,000 for each such failure.

If the Company fails to comply with the requirements to send annual letters to certain shareholders requesting information regarding the actual ownership of the Company's outstanding stock and the failure was not due to reasonable cause or was due to willful neglect, the Company will be subject to a \$25,000 penalty or, if the failure is intentional, a \$50,000 penalty.

If the Company elects to retain and pay federal income tax on its net long-term capital gain, in which case a stockholder would include in its proportionate share of the Company's undistributed long-term capital gain in its income, would be allowed a credit for its proportionate share of the tax it is deemed to have paid, and an adjustment would be made to increase the stockholder's basis in the Company's common stock.

In addition, notwithstanding the Company's status as a REIT, the Company also may have to pay certain state and local income taxes, because not all state and local jurisdictions treat REITs the same as they are treated for federal income tax purposes. Moreover, the Company's taxable REIT subsidiary (as further described below) is subject to federal, state and local corporate income taxes on its net income.

Relief Provisions

The Code provides relief from violations of the REIT qualification requirements in certain circumstances which, if available, would allow the Company to continue to be taxable as a REIT. For example, relief may be available for a violation of the REIT gross income requirements, as described below under *Operational Requirements Gross Income Tests*, in cases where a violation is due to reasonable cause and not willful neglect, and other requirements are met, including the payment of a penalty tax that is based upon the magnitude of the violation. In addition, the Code includes provisions that extend similar relief in the case of certain violations of the REIT asset requirements (see *Operational Requirements Asset Tests* below) and other REIT requirements, again provided that the violation is due to reasonable cause and not willful neglect, and other conditions are met, including the payment of penalty tax. If the Company fails to satisfy any of the various REIT

Table of Contents

requirements, there can be no assurance that these relief provisions would be available to enable the Company to maintain its qualification as a REIT. Even if these relief provisions are available to the Company, the amount of any resultant penalty tax could be substantial and impair its ability to maintain operations or make distributions to the Company's stockholders.

Requirements for Qualification as a REIT

In order for the Company to qualify as a REIT, it must meet and continue to meet the requirements discussed below relating to its organization, sources of income, nature of assets and distributions of income to its stockholders.

Organizational Requirements

In order to qualify for taxation as a REIT under the Code, the Company must meet tests regarding its income and assets described below. The Code defines a REIT as a corporation, trust or association:

- (1) that is managed by one or more trustees or directors;
- (2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
- (3) that would be taxable as a domestic corporation, but for the REIT rules set forth in Sections 856 through 859 of the Code;
- (4) that is neither a financial institution nor an insurance company subject to certain provisions of the Code;
- (5) the beneficial ownership of which is held by 100 or more persons;
- (6) not more than 50% in value of the outstanding shares of which is owned, actually or constructively, by or for five or fewer individuals (as defined in the Code to include certain entities);
- (7) that makes an election to be a REIT (or has made such election for a previous taxable year which has not been revoked or terminated) and satisfies all relevant filing and other administrative requirements that must be met in order to elect and maintain REIT status;
- (8) that uses a calendar year for federal income tax purposes;
- (9) that does not have at the end of any taxable year any undistributed earnings and profits that were accumulated in any taxable year to which the provisions of Sections 856 through 859 did not apply; and
- (10) that meets certain other tests, described below, regarding the nature of its income and assets and the amount of its distributions to shareholders.

The Code provides that conditions (1), (2), (3) and (4) above must be met during the entire taxable year, that condition (5) above must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a shorter taxable year, and that condition (6) must be met during the last half of each taxable year. For purposes of determining stock ownership under condition (6) above, a supplemental unemployment compensation benefits plan, a private foundation or a portion of a trust permanently set aside or used exclusively for charitable purposes generally is treated as an individual. A pension trust that is qualified under Section 401(a) of the Code, however, generally is not considered an individual, and beneficiaries of such trust are treated as holding shares of a REIT in proportion to their actuarial interests in such trust for purposes of condition (6) above. Finally, the Company will be treated as having met condition (6) above if the Company complies with

Table of Contents

certain Treasury Regulations for ascertaining the ownership of its outstanding stock and if the Company did not know (or after the exercise of reasonable diligence would not have known) that its stock was sufficiently closely held during such year to cause the Company to fail condition (6).

The Company believes that it has been organized, has operated and has issued sufficient shares of beneficial ownership with sufficient diversity of ownership to allow the Company to satisfy each of the above conditions. In addition, the Company's organizational documents contain restrictions regarding the transfer and ownership of stock that are intended to assist the Company in continuing to satisfy conditions (5) and (6) above but without causing the Company to violate the freely transferable shares requirement described in condition (2) above. See Description of Piedmont Office Realty Trust, Inc. Capital Stock Restrictions on Ownership and Transfer for additional information.

Ownership of Subsidiary REIT

The Company owns indirectly 100% of the outstanding common stock of a subsidiary that has elected to be treated as a REIT for U.S. federal income tax purposes. The subsidiary REIT is subject to the various REIT qualification requirements and other limitations described herein that are applicable to the Company. The Company believes that the subsidiary REIT has been organized and operated and will continue to be organized and operated in a manner to permit it to qualify for taxation as a REIT for federal income tax purposes. However, if the subsidiary REIT were to fail to qualify as a REIT, then (i) the subsidiary REIT would become subject to regular U.S. corporation income tax, as described herein, see Failure to Qualify as a REIT below, and (ii) the Company's indirect interest in the stock of the subsidiary REIT would cease to be a qualifying real estate asset for purposes of the 75% asset test and would become subject to the 5% asset test, the 10% voting stock asset test, and the 10% value asset test generally applicable to the Company's ownership in non-REIT corporations, qualified REIT subsidiaries and taxable REIT subsidiaries. See Operational Requirements Asset Tests below. If the subsidiary REIT were to fail to qualify as a REIT, the Company would not meet the 10% voting stock test and the 10% value test with respect to the Company's indirect interest in such REIT, in which event the Company would fail to qualify as a REIT unless it could avail itself of certain relief provisions.

Qualified REIT Subsidiaries

For purposes of the requirements described herein, any corporation the Company owns that is a qualified REIT subsidiary will not be treated as a corporation separate from the Company and all of its assets, liabilities, and items of income, deduction and credit will be treated as the Company's assets, liabilities and items of income, deduction and credit. A qualified REIT subsidiary is a corporation, other than a taxable REIT subsidiary (as described below under Operational Requirements Asset Tests), all of the capital stock of which is owned by a REIT.

Interests in Partnerships

In the case of a REIT that is a partner in an entity or arrangement treated as a partnership for federal tax purposes, the REIT is treated as owning its proportionate share of the assets of the partnership and as earning its allocable share of the gross income of the partnership for purposes of the requirements described herein. In addition, the character of the assets and gross income of the partnership will retain the same character in the hands of the REIT for purposes of the REIT requirements, including the asset and income tests described below. As a result, the Company's proportionate share of the assets, liabilities and items of income of the Operating Partnership and of any other partnership, joint venture or other arrangement is granted. We may not: reduce the exercise price of any stock option outstanding or to be granted in the future under the 1997 Plan; cancel and re-grant options at a lower exercise price (including entering into any "6 month and 1 day" cancellation and re-grant scheme), whether or not the cancelled options are put back into the available pool for grant; replace underwater options with restricted stock in an exchange, buy-back or other scheme; or replace any options with new options having a lower exercise price or accelerated vesting schedule in an exchange, buy-back or other scheme. (c) Termination of Employment. If the optionee's employment or consulting relationship with us is terminated for any reason other than death or total and permanent disability, options under the 1997 Plan may be exercised not later than thirty days (or such other period of time not exceeding the expiration of the term of the option, as determined by the Administrator) after the date of such termination to the extent the option was exercisable on the date of such termination. In no event may an option be exercised by any person after the expiration of its term. (d) Termination of Options. Nonstatutory options granted under the 1997 Plan expire ten years from the date of grant unless a shorter period is provided in the option agreement. (e) Nontransferability of Options. Generally, options under the 1997 Plan are nontransferable by the optionee, other than by will or the laws of descent and distribution, and are exercisable only by the optionee during his or her lifetime. However, the Administrator may, in its discretion, grant transferable nonstatutory stock options pursuant to option agreements specifying (i) the manner in which the nonstatutory options are transferable and (ii) that any such transfer be subject to applicable law. (f) Effect of Corporate Transactions. In the event of our proposed dissolution or liquidation, the options under the 1997 Plan will terminate immediately prior to the consummation of the proposed action, unless otherwise provided by the Administrator. The Administrator may, in the exercise of its sole discretion in such instances, declare that any option be terminated as of a date fixed by the Administrator and give each optionee the right to exercise the optionee's option as to all or any part of the option, including shares as to which the option would not otherwise be exercisable. In the event of a sale of all or substantially all of our assets, or our merger with another corporation, an option granted under the 1997 Plan will be assumed or an equivalent option will be substituted by the successor corporation or a parent or subsidiary of the successor corporation. If the successor corporation does

not assume or provide substitute options, the Administrator will make provisions for the acceleration of the optionee's right to exercise his or her outstanding options in full. If the Administrator makes an option fully exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrator will notify the optionee that the option will be fully exercisable for a period of 15 days from the date of the notice, and the option will terminate upon the expiration of such period. 61 Amendment and Termination. Our board may terminate the 1997 Plan, or may amend the 1997 Plan from time to time in any respect, as it feels advisable. The 1997 Plan will terminate in January, 2007, but any options then outstanding under the 1997 Plan will remain outstanding until they expire by their terms. 1998 Stock Option Plan Our 1998 Stock Option Plan (the "1998 Plan") was assumed by us upon the consummation of the merger between Visioneer, Inc. and Scansoft, Inc. on March 12, 1999. As of December 31, 2002, there were outstanding options to purchase 919,081 shares of common stock under the 1998 Plan, with exercise prices ranging from \$0.6100 to \$1.3438 per share. As of December 31, 2002, there were no shares available for future grants. General. The purpose of the 1998 Plan is to obtain and retain the services of the types of employees, consultants, officers and directors who will contribute to our long range success and to provide incentives which are linked directly to increases in share value which will benefit all of our stockholders. Options granted under the 1998 Plan may be either "incentive stock options" or nonstatutory stock options. However, only officers and employees are eligible to be granted incentive stock options. Administration. The 1998 Plan may be administered by our Board or a committee appointed by our Board (as applicable, the "Administrator"). The Administrator may make any determinations deemed necessary or advisable for the 1998 Plan. Eligibility. Directors, officers, employees and consultants who, as determined by the Administrator, are responsible for or contribute to the management, growth or profitability of our business may be granted stock options under the 1998 Plan. However, only officers and employees may be granted incentive stock options. As of December 31, 2002, we had approximately 489 employees, seven directors (including two employee directors), and 24 consultants. The Administrator, in its discretion, selects the directors, officers, employees and consultants to whom options may be granted, the time or times at which such options are granted, and the exercise price (within the limits described below) and number of shares subject to each such grant. Limitations. The 1998 Plan provides that no one may be granted, during any one year period, options to purchase more than 1,000,000 shares of our common stock. Terms and Conditions of Options. Each option is evidenced by a stock option agreement between us and the optionee, and is subject to the following terms and conditions: (a) Exercise Price. The Administrator determines the exercise price of options at the time the options are granted. The exercise price for incentive stock options may not be less than 100% of the fair market value of the shares of stock on the grant date. In the case of nonstatutory options, the exercise price may be determined in the sole discretion of the Administrator, provided, that the exercise price may not be less than 85% of the fair market value of the shares of stock on the grant date of the nonstatutory option. In the case of either an incentive stock option or a nonstatutory option granted to a 10% stockholder, the exercise price may not be less than 110% of the fair market value. The fair market value of our common stock is generally determined with reference to the closing sale price for the common stock on the last market trading day prior to the date the option is granted. (b) Exercise of Option; Form of Consideration. The Administrator determines when options become exercisable, and may in its discretion, accelerate the vesting of any outstanding option. The 1998 Plan provides that options granted under the 1998 Plan must vest at a rate of at least 20% per year over a period of five years from the grant date, unless a lower vesting rate or longer vesting period is permitted by applicable law or regulation. In the case of an incentive stock option granted to a 10% stockholder, the vesting or exercise period may not exceed five years from the grant date. The 1998 Plan provides that the exercise price must be paid in full at the time of exercise in cash. 62 (c) Term of Option. The term of an incentive stock option may be no more than ten years from the grant date; provided, however, that in the case of an incentive stock option granted to a 10% stockholder, the term of the option may be no more than five years from the date of grant. No option may be exercised after the expiration of its term. (d) Termination of Service. If an optionee's service relationship terminates for any reason, then the optionee generally may exercise the option within 80 days of such termination, to the extent that the option is vested on the date of termination (but in no event later than the expiration of the term of such option as set forth in the option agreement). (e) Nontransferability of Options. Unless otherwise determined by the Administrator, options granted under the 1998 Plan are not transferable other than by will or the laws of descent and distribution, and may be exercised during the optionee's lifetime only by the optionee or by the optionee's guardian or legal representative. (f) Other Provisions. The stock option agreement may contain other terms, provisions and conditions not inconsistent with the 1998 Plan as may be determined by the Administrator. Adjustments Upon Changes in Capitalization. In the event that our stock changes by reason of any stock split, reverse stock split, stock dividend, recapitalization, combination or reclassification in our capital structure, appropriate adjustments shall be made in the number and class of shares of stock subject to the 1998 Plan, the number and class of shares of stock subject to any option outstanding under the 1998 Plan, and the exercise price of any such outstanding option or stock purchase right. In the event of a liquidation or dissolution, the Administrator may provide that the holder of any option then exercisable have the right to exercise that option subsequent to the liquidation or dissolution, and for the balance of its term, solely for the kind and amount of shares of stock and other securities, cash or other property receivable upon such liquidation or dissolution by a holder of the number of shares of stock for which the option might have been exercised immediately prior to the liquidation or dissolution. The Administrator may also provide, in the alternative, that each option granted under the 1998 Plan terminate as of a date to be fixed by the Board provided that written notice is given to each optionee at least 30 days prior to the termination date. Each option holder then has the right, during the 30 days preceding the option termination, to exercise the option as to all or any part of the shares of stock covered by the option, to the extent that the option is then exercisable. In the case of any capital reorganization, any reclassification of the common stock (other than a change in par value or recapitalization), or the consolidation of our company with, or a sale of substantially all of our assets (which sale is followed by our liquidation or dissolution), or merger of our company with another person (a "Reorganization Event"), the Administrator is to determine whether the Reorganization Event constitutes a liquidation or dissolution and to deliver to optionees at least 15 days prior to the Reorganization Event a notice which (i) indicates whether the Reorganization Event is a liquidation or dissolution, and (ii) advises the optionee of his or her rights pursuant to the stock option agreement. If the Reorganization Event is determined to be a liquidation or dissolution, in its sole and absolute discretion, the surviving corporation may, but is not be obligated to, (i) tender stock options to the optionee with respect to the surviving corporation which contains terms and provisions that substantially preserve the rights and benefits of the optionee, and (ii) in the event that no stock options have been tendered by the surviving corporation, the optionee has the right exercisable during a 10-day period ending on the fifth day prior to the Reorganization Event to exercise his or her options, to the extent that such options are then exercisable. If the Reorganization Event is not determined to be a liquidation or

dissolution, the optionee is entitled upon exercise of the option to purchase the kind and number of shares of stock or other securities, cash or other property of the surviving corporation receivable upon such event by a holder of the number of shares of the common stock which the option entitles the optionee to purchase from us immediately prior to such event. In the case of any Reorganization Event that is a reorganization, merger or consolidation in which we are not the surviving corporation, the Administrator may, in its sole and absolute discretion, accelerate the vesting period of the options. Amendment and Termination of the Plan. The Board may amend, alter, or discontinue the 1998 Plan. However, we must obtain stockholder approval for any amendment to the 1998 Plan which would: (i) increase the total number of shares of stock reserved for the purposes of the 1998 Plan; (ii) materially increase the benefits accruing to eligible persons under the 1998 Plan; or (iii) materially modify the requirements for eligibility under the 1998 Plan. No such action by the Board or stockholders may alter or impair any option previously granted under the 1998 Plan without the written consent of the optionee. No options may be granted under the 1998 Plan on or after December 31, 2002. 2000 Stock Plan Our 2000 Stock Plan (the "2000 Plan") was adopted by our board and approved by our stockholders in May, 2000, and was last amended by the board on April 5, 2002 and by the stockholders on June 14, 2002. As of December 31, 2002, there were options to purchase 2,612,837 shares of common stock under the Plan, with exercise prices ranging from \$1.2813 to \$6.97 per share. In addition, as of the same date, there were available for future grant options to purchase 1,701,113 shares of common stock. General. The purpose of the 2000 Plan is to attract and retain the best available personnel for positions of substantial responsibility with our company, to provide additional incentive to our employees and consultants and to promote the success of our business. Options granted under the 2000 Plan may be either incentive stock options or nonstatutory stock options. Stock purchase rights may also be granted under the Plan. Administration. The 2000 Plan generally may be administered by the board or a committee appointed by the board (as applicable, the "Administrator"). The Administrator may make any determinations deemed necessary or advisable for the 2000 Plan. Eligibility. Nonstatutory stock options and stock purchase rights may be granted under the 2000 Plan to our employees, directors and consultants. As of December 31, 2002, we had approximately 489 employees, seven directors (including two employee directors), and 24 consultants. Incentive stock options may be granted only to employees. The Administrator, in its discretion, selects the employees, directors and consultants to whom options and stock purchase rights may be granted, the time or times at which such options and stock purchase rights shall be granted, and the exercise price and number of shares subject to each such grant; provided, however, the exercise price of a stock option may not be less than 100% of the fair market value of the common stock on the date such option is granted. Limitations. Section 162(m) of the Code places limits on the deductibility for federal income tax purposes of compensation paid to certain of our executive officers. In order to preserve our ability to deduct the compensation income associated with options granted to such persons, the 2000 Plan provides that no employee may be granted, in any fiscal year, options or stock purchase rights to purchase more than 750,000 shares of common stock. Notwithstanding this limit, however, in connection with such individual's initial employment with us, he or she may be granted options or stock purchase rights to purchase up to an additional 750,000 shares of common stock. Terms and Conditions of Options. Each option is evidenced by a stock option agreement between us and the optionee, and is subject to the following terms and conditions: (a) Exercise Price. The Administrator determines the exercise price of options at the time the options are granted. The exercise price of a stock option may not be less than 100% of the fair market value of the common stock on the date such option is granted; provided, however, that the exercise price of an incentive stock option granted to a 10% stockholder may not be less than 110% of the fair market value on the date such option is granted. The fair market value of the common stock is generally determined with reference to the closing sale price for the common stock (or the closing bid if no sales were reported) on the last market trading day prior to the date the option is granted. (b) We may not: reduce the exercise price of any stock option, including stock appreciation right, outstanding or to be granted in the future under the 2000 Plan; cancel and re-grant options at a lower exercise price (including entering into any "6 month and 1 day" cancellation and re-grant scheme), whether or not the cancelled options are put back into the available pool for grant; replace underwater options with restricted stock in an exchange, buy-back or other scheme; or replace any options with new options having a lower exercise price or accelerated vesting schedule in an exchange, buy-back or other scheme. (c) Exercise of Option; Form of Consideration. The Administrator determines when options become exercisable, and may in its discretion, accelerate the vesting of any outstanding option. The means of payment for shares issued upon exercise of an option is specified in each option agreement. The 2000 Plan permits payment to be made by cash, check, promissory note, other shares of our common stock (with some restrictions), cashless exercises, any other form of consideration permitted by applicable law, or any combination thereof. (d) Term of Option. The term of an incentive stock option may be no more than ten years from the date of grant; provided, however, that in the case of an incentive stock option granted to a 10% stockholder, the term of the option may be no more than five years from the date of grant. No option may be exercised after the expiration of its term. (e) Termination of Service. If an optionee's service relationship terminates for any reason (excluding death or disability), then the optionee generally may exercise the option within 90 days of such termination or within such time period as specified in the option agreement, to the extent that the option is vested on the date of termination, (but in no event later than the expiration of the term of such option as set forth in the option agreement). If an optionee's service relationship terminates due to the optionee's disability, the optionee generally may exercise the option, to the extent the option was vested on the date of termination, within 12 months, or as specified in the option agreement, from the date of such termination. If an optionee's service relationship terminates due to the optionee's death, the optionee's estate or the person who acquires the right to exercise the option by bequest or inheritance generally may exercise the option, as to the vested shares subject to the option (not including unvested shares), within 12 months from the date of such termination or as defined in the option agreement. (f) Nontransferability of Options. Unless otherwise determined by the Administrator, options granted under the 2000 Plan are not transferable other than by will or the laws of descent and distribution, and may be exercised during the optionee's lifetime only by the optionee. (g) Other Provisions. The stock option agreement may contain other terms, provisions and conditions not inconsistent with the 2000 Plan as may be determined by the Administrator. Stock Purchase Rights. In the case of stock purchase rights, unless the Administrator determines otherwise, the restricted stock purchase agreement shall grant us a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's employment with us for any reason (including death or disability). The purchase price for shares repurchased pursuant to the restricted stock purchase agreement shall be the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to us. The repurchase option shall lapse at a rate determined by the Administrator. Adjustments Upon Certain Corporate Transactions. In connection with any merger of our company with or into another corporation or the sale of all or substantially all of our assets, each outstanding option and stock purchase right shall be assumed or an equivalent

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option or right substituted by the successor corporation. If the successor corporation refuses to assume the options or rights or to substitute substantially equivalent options or rights, the optionee shall have the right to exercise the option or stock purchase right as to all the optioned stock, including shares not otherwise vested or exercisable. In such event, the Administrator shall notify the optionee that the option or stock purchase right is fully 65 exercisable for fifteen days from the date of such notice and that the option terminates upon expiration of such period. Amendment and Termination of the Plan. The board may amend, alter, suspend or terminate the 2000 Plan, or any part thereof, at any time and for any reason. Unless terminated earlier, the 2000 Plan shall terminate ten years from the date the 2000 Plan or any amendment to add shares to the 2000 Plan was last adopted by the board. Plan Benefits. The amount and timing of options and awards granted under the 2000 Plan are determined in the sole discretion of the Administrator. As a result, the benefits or amounts that will be received by, or allocated to, our CEO, our other named executive officers and our current directors under the 2000 Plan for 2003 are not determinable. However, the following sets forth the options or awards granted to such persons in fiscal year 2002. Amounts granted in 2002 may not be representative of amounts granted in the future.

NAME	DOLLAR VALUE	NUMBER OF UNITS
Paul A. Ricci.....	\$ 5,878,429	
961,554 Michael K. Tivnan.....	\$ 122,840	22,918
Wayne S. Crandall.....	\$ 697,000	100,000
Richard S. Palmer.....		
-- Robert Weideman.....		
-- Ben S. Wittner.....	\$ 12,667	
67,895 Executive Group.....	\$6,710,936	1,152,367
Non-Executive Director Group.....		
-- Non-Executive Officer Employee Group.....		
-- 401(K) RETIREMENT PLAN		

The 401(k) plan provides that each participant may contribute up to 15% of his or her pre-tax gross compensation up to the statutory limit, which was \$10,500 in calendar year 2001. Through October 15, 2002, we provided a match of an employee's contributions dollar for dollar up to 4%. For example, if an employee contributed 6% we matched at 4%; if the employee contributed 4% we matched the 4%; if the employee contributed 2% we matched the 2%, and so on. Employees are 100% vested into the plan as soon as they start to contribute to the plan. Effective October 16, 2002, this match was discontinued.

LIMITATIONS ON DIRECTORS' LIABILITY AND INDEMNIFICATION Our certificate of incorporation provides that our directors will not be personally liable to us or our stockholders for monetary damages for breach of their fiduciary duties as directors, except liability for any of the following: - any breach of their duty of loyalty to the corporation or its stockholders; - acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; - payments of dividends or approval of stock repurchases or redemptions that are prohibited by Delaware law; or - any transaction from which the director derived an improper personal benefit. This limitation of liability does not apply to liabilities arising under the federal securities laws and does not affect the availability of equitable remedies such as injunctive relief or rescission. Our certificate of incorporation and bylaws provide that we shall indemnify our directors, officers, employees and other agents to the fullest extent permitted by law. We believe that indemnification under our bylaws covers at least negligence and gross negligence on the part of indemnified parties. Our bylaws 66 also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in such capacity, regardless of whether Delaware law would permit indemnification. We have entered into agreements to indemnify our directors and executive officers, in addition to the indemnification provided for in our certificate of incorporation and bylaws. These agreements, among other things, provide for indemnification of our directors and officers for expenses, judgments, fines, penalties and settlement amounts incurred by any such person in any action or proceeding arising out of such person's services as a director or officer or at our request. We believe that these provisions and agreements are necessary to attract and retain qualified persons as directors and executive officers. There is no pending litigation or proceeding involving any of our directors, officers, employees or agents. We are not aware of any pending or threatened litigation or proceeding that might result in a claim for indemnification by a director, officer, employee or agent.

67 CERTAIN RELATIONSHIPS AND SECURITIES TRANSACTIONS RELATED PARTY TRANSACTIONS At December 31, 2002, Xerox owned approximately 18.7% of our outstanding common stock and all of our outstanding Series B Preferred Stock. In connection with our acquisition of ScanSoft in 1999 (following which we renamed ourselves ScanSoft), we issued 3,562,238 shares of Series B Preferred Stock to Xerox. The Series B Preferred Stock is convertible into shares of common stock on a share for share basis. The Series B Preferred Stock has a liquidation preference of \$1.30 per share plus all declared but unpaid dividends. The Series B Preferred Stockholders are entitled to non-cumulative dividends at the rate of \$0.05 per annum per share, payable when, as and if declared by the Board of Directors. To date no dividends have been declared by the Board of Directors. Holders of Series B Preferred Stock have no voting rights, except those rights provided under Delaware law. See "Description of Capital Stock" below for a discussion of the rights, preferences, privileges and restrictions of our Series B Preferred Stock. In addition, Xerox has the opportunity to acquire additional shares of common stock pursuant to a ten-year warrant. The warrant allows Xerox to acquire a number of shares of common stock equal to the number of options (whether vested or unvested) that remain unexercised at the expiration of any ScanSoft option assumed by us in the merger. The exercise price for each warrant share is \$0.61. If all of the assumed ScanSoft options expire without being exercised, Xerox would be entitled to purchase 1,736,630 shares of common stock. The warrant was fully vested on the date of grant; however, Xerox could not exercise the warrant prior to March 2, 2002, unless, immediately after such exercise, Xerox owned directly or indirectly less than 45% of the shares of our common stock outstanding immediately after such exercise. From the date of acquisition through December 31, 2002, approximately 525,732 ScanSoft options have been forfeited. Accordingly, Xerox had the opportunity to acquire up to a maximum of 525,732 shares of our common stock as of December 31, 2002. We and Xerox have entered into three non-exclusive agreements in which we granted Xerox the royalty-bearing right to copy and distribute certain of our software programs with Xerox's multi-function peripherals. All agreements were negotiated on an arm's length basis, and the royalties and other economic terms are comparable with our other OEM agreements. On June 29, 1998, we and Xerox entered into a Gold Disk Bundling Agreement, wherein we granted to Xerox a non-exclusive license to bundle and distribute certain of our software products with Xerox's document system products for the small office and home office market. Under this agreement, as amended, Xerox paid us \$0.5 million in non-refundable advances representing pre-paid royalties on the licensed software. We recorded revenue totaling \$1.8 million, \$2.4 million and \$0.5 million for the years ended December 31, 2001, 2000 and 1999 respectively, under this agreement. On June 14, 2001 Xerox announced its exit from the small office/home office business segment, therefore, revenue for the nine months ended September 30, 2002 was zero. On March 25, 1998, we and Xerox entered into a Gold Disk Bundling Agreement, wherein we granted to Xerox a non-exclusive license to bundle and distribute certain of our software with Xerox's large corporate multifunction devices for more than 25 users. On September 30, 1999, we and Xerox entered into a Gold Disk Bundling Agreement, wherein we granted to Xerox a non-exclusive license to bundle and distribute certain of our software with Xerox's large

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corporate multifunction devices and document center systems. Under this agreement, which superseded the March 25, 1998 Agreement, Xerox agreed to pay us a one-time non-refundable license fee of \$0.6 million, in addition to royalties on the licensed software. Under these two agreements, we recorded revenue totaling \$5.4 million, \$3.4 million and \$4.2 million for the years ended December 31, 2001, 2000 and 1999 respectively. For the nine months ended September 30, 2002, we recorded revenue totaling \$3.6 million. In total, Xerox accounted for \$7.2 million, \$5.9 million and \$4.7 million of our revenue for the years ended December 31, 2001, 2000 and 1999 respectively, accounting for 11%, 11% and 14% of our total revenue, respectively. For the nine months ended September 30, 2002, Xerox accounted for revenue of \$3.6 million or 5% of total revenue. During 2001, Xerox paid us \$7.0 million under these agreements, and 68 as of December 31, 2001, Xerox owed us \$1.8 million. For the first nine months of 2002, Xerox paid us \$4.0 million under these agreements and as of September 30, 2002, Xerox owed us \$1.2 million. We believe that the terms under the June 29, 1998, March 25, 1998 and September 30, 1999 agreements were no more favorable than those we would have negotiated with unrelated parties. The law firm of Wilson Sonsini Goodrich & Rosati, Professional Corporation acts as our primary outside corporate and securities counsel. Ms. Martin, one of our directors, and the owner of record of 1,000 shares of our common stock and 95,000 options to purchase shares of our common stock, is a member of Wilson Sonsini Goodrich & Rosati. As such, Ms. Martin is contractually obligated to transfer a portion of these options to a fund for the benefit of all members of Wilson Sonsini Goodrich & Rosati. Aggregate fees and costs billed to us during the 12 months ended December 31, 2002 by Wilson Sonsini Goodrich & Rosati were approximately \$1.5 million. We believe that the services performed by Wilson Sonsini Goodrich & Rosati were provided to us on terms no less favorable than those provided to us by unrelated parties. SECURITIES TRANSACTIONS On September 13, 1999, we purchased 600,000 shares of Series A Preferred Stock at a cost of \$0.25 per share for a total investment of \$150,000 in BookmarkCentral.com (which was recently renamed EchoBahn.com, Inc.). One of our former directors is a founder and the current President and Chief Executive Officer of EchoBahn. During 2001, the Company wrote-off its investment in EchoBahn after determining that the investment was impaired. We accounted for the investment under the cost basis method of accounting. In September 2002, we repurchased 1,461,378 shares of common stock from L&H and certain other parties for \$7.0 million. These shares represented a portion of the common shares that we issued to the selling stockholders in connection with our December 12, 2001 acquisition of certain of L&H's speech and language technology operations and our March 21, 2002 acquisition of the AudioMining assets of L&H Holdings USA, Inc. We agreed to issue 150,000 shares of our common stock to the selling stockholders if we do not complete an underwritten public offering for the selling stockholders by December 15, 2002. To fulfill this obligation, on December 18, 2002, we issued 81,900 shares to Lernout & Hauspie Speech Products, N.V. and 68,100 shares to L&H Holdings USA, Inc. We further agreed to issue an additional 150,000 shares of our common stock to the selling stockholders if we do not complete an underwritten public offering for the selling stockholders by February 15, 2003. We also will be required to issue an additional 100,000 shares of our common stock to L&H if, by February 15, 2003, we fail to file a registration statement to register the shares remaining unsold, if any, after this offering. Additionally, if the consummation of this offering does not occur by January 1, 2003, the outstanding principal and interest under the \$3.5 million promissory note, dated December 12, 2001, that we issued in connection with the acquisition of L&H's speech and language technologies business would become immediately due and payable. To fulfill this obligation, on January 3, 2003, we paid \$3.3 million in full settlement of all of the outstanding principal and accrued interest under this note. In connection with the Philips acquisition, in January 2003 we issued to Philips a \$27.5 million three-year, zero-interest convertible subordinate debenture. This debenture is convertible into shares of our common stock at any time at the option of Philips at a conversion price of \$6.00 per share. We also issued a note to Philips with a principal amount of euro 5 million due December 31, 2003 and bearing 5.0% interest per annum. 69 PRINCIPAL AND SELLING STOCKHOLDERS The following table sets forth information with respect to the beneficial ownership of our common stock as of December 31, 2002, as to: - each person (or group of affiliated persons) who is known by us to beneficially own more than 5% of our common stock; - each of our directors; - each officer named in the Summary Compensation Table; and - all of our current directors and executive officers as a group. The information has been adjusted to reflect the sale of our common stock in this offering. The information assumes no exercise of the underwriters' over-allotment option. Beneficial ownership is determined in accordance with SEC rules and includes voting or investment power with respect to securities. All shares of common stock subject to options exercisable within 60 days of December 31, 2002 are deemed to be outstanding and beneficially owned by the persons holding those options for the purpose of computing the number of shares beneficially owned and the percentage ownership of that person. They are not, however, deemed to be outstanding and beneficially owned for the purpose of computing the percentage ownership of any other person. Subject to the paragraph above, percentage ownership of outstanding shares is based on 63,422,776 shares of common stock outstanding as of December 31, 2002. Percentage ownership after offering reflects an additional 1,000,000 shares to be sold by us in this offering. PERCENTAGE OF NUMBER OF BENEFICIAL NUMBER OF SHARES OWNERSHIP SHARES NUMBER OF BENEFICIALLY ----- BENEFICIALLY SHARES BEING OWNED AFTER BEFORE AFTER NAME AND ADDRESS OF BENEFICIAL OWNER(1) OWNED SOLD OFFERING OFFERING OFFERING -----

5% STOCKHOLDERS: Xerox Corporation.....	15,941,572(2) --	15,941,572(2)	23.6%	23.3%	800 Long Ridge Road Stamford, CT 06904 State of Wisconsin Investment Board...
Lernout & Hauspie Speech Products N.V.(3).....	4,122,300	4,122,300 --	6.5%	--	Flanders Language Valley 50 8900 Ieper, Belgium L&H Holdings USA, Inc.(3).....
2,062,106	2,062,106 --	3.3%	--	52 Third Avenue Burlington, MA. 01803 DIRECTORS AND OFFICERS: Paul A. Ricci(4).....	
3,065,720	3,065,720	4.6%	4.6%	Michael K. Tivnan(5).....	
1,019,854	1,019,854	1.7%		1.7% Mark B. Myers(6).....	
80,000	80,000	*	*	Katharine A. Martin(7).....	
96,000	96,000	*	*	Robert G. Teresi(8).....	
242,186	242,186	*	*	Robert J. Frankenberg(9).....	
211,708	211,708	*	*	Wayne S. Crandall(10).....	
554,010	554,010	*	*	Richard S. Palmer(11).....	
587,500	587,500	*	*	70 PERCENTAGE OF BENEFICIAL NUMBER OF SHARES OWNERSHIP SHARES NUMBER OF BENEFICIALLY ----- BENEFICIALLY SHARES BEING OWNED AFTER BEFORE AFTER NAME AND ADDRESS OF BENEFICIAL OWNER(1) OWNED SOLD OFFERING OFFERING OFFERING -----	
Ben S. Wittner(12).....	347,662	--	347,662	*	* All directors and executive officers as a group (10 persons)(13).....
6,513,744	6,513,744	9.4%	9.3%	-----	* Less than 1%. (1) Unless otherwise indicated, the address for the following stockholders is c/o ScanSoft, Inc., 9 Centennial Drive, Peabody, Massachusetts 01960. (2) Includes a warrant that as of December 31, 2002 was exercisable for up to 525,732 shares of our common stock, and 3,562,238 shares of

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non-voting Series B Preferred Stock. The shares that underlie this warrant and the Series B shares have not been converted into common stock and are factored into the calculation of Xerox's beneficial ownership only for the purposes of this table. As of December 31, 2002, Xerox owned 11,853,602 shares of our common stock. All of these securities are owned of record by Xerox Imaging Systems, Inc., a wholly-owned subsidiary of Xerox Corporation. (3) Of the 6,184,406 shares listed above, 4,122,300 are held of record by Lernout & Hauspie Speech Products N.V., and 2,062,106 are held of record by L&H Holdings USA, Inc. All of these shares are being offered for sale pursuant to this prospectus. Investment and voting control over these shares is held by Allan Forsey and Jean-Marc Vanstaen subject, under certain circumstances, to bankruptcy court approval. Mr. Forsey is the Plan Administrator for L&H Holdings USA, Inc. and Mr. Vanstaen is a curator on behalf of Lernout & Hauspie Speech Products N.V. For further information, see "Certain Relationships and Securities Transactions." (4) Includes options to acquire 2,910,720 shares of our common stock that are exercisable through March 1, 2003. (5) Includes options to acquire 1,019,854 shares of our common stock that are exercisable through March 1, 2003. (6) Represents options to acquire shares of our common stock that are exercisable through March 1, 2003. (7) Includes options to acquire 95,000 shares of our common stock that are exercisable through March 1, 2003. (8) Includes options to acquire 70,000 shares of our common stock that are exercisable through March 1, 2003. (9) Represents options to acquire shares of our common stock that are exercisable through March 1, 2003. (10) Includes options to acquire 526,010 shares of our common stock that are exercisable through March 1, 2003. (11) Includes 75,000 shares of restricted stock with a 2 1/2 year cliff vesting, which vest 100% on April 17, 2004, and options to acquire 510,500 shares of our common stock that are exercisable through March 1, 2003. (12) Includes options to acquire 343,254 shares of our common stock that are exercisable through March 1, 2003. (13) Includes 75,000 shares of restricted stock issued to Mr. Palmer (see note 11 above); 58,824, of which 19,608 was released, shares of restricted stock issued to Mr. Weideman, restrictions on which will lapse 1/3 on each anniversary date of grant; and options to acquire 5,933,796 shares of our common stock that are exercisable through March 1, 2003.

71 DESCRIPTION OF CAPITAL STOCK The following description of our capital stock is qualified in its entirety by the provisions of our amended and restated certificate of incorporation and bylaws, which have been incorporated by reference into Part II of the Registration Statement.

AUTHORIZED AND OUTSTANDING CAPITAL STOCK Our charter provides that we are authorized to issue 140,000,000 shares of common stock, \$0.001 par value per share, and 40,000,000 shares of preferred stock, \$0.001 par value per share. As of December 31, 2002, there were outstanding 63,422,776 shares of common stock held by approximately 566 stockholders of record, and 3,562,238 shares of Series B preferred stock held by Xerox. As of December 31, 2002, there were no shares of Series A preferred stock outstanding.

COMMON STOCK The holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders. Subject to preferences that may be applicable to any outstanding preferred stock (see "Preferred Stock" below), the holders of common stock are entitled to receive such dividends, if any, as may be declared from time to time by our board out of legally available funds. In the event of a liquidation, dissolution or winding up of our company, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior rights of the preferred stock. The common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions available to the common stock. The rights, preferences, and privileges of holders of the common stock are subject to, and may be adversely affected by, the rights of holders of shares of our preferred stock, as discussed below.

PREFERRED STOCK Our board may issue preferred stock in different series and classes and fix the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), liquidation preferences, and other rights and preferences of preferred stock not in conflict with our charter or Delaware law. Our charter currently designates two series of preferred stock: the Series A Participating Preferred Stock consisting of 100,000 shares and the Series B Preferred Stock consisting of 15,000,000 shares. Our preferred stock may have the effect of delaying, deferring or preventing a change in control of our company without further action by the stockholders (see "Anti-Takeover Provisions below). Additionally, the issuance of preferred stock may adversely affect the rights of the holders of common stock as follows:

- **Dividends.** Our preferred stock is entitled to receive dividends out of any legally available assets, when and if declared by our board prior and in preference to any declaration or payment of any dividend on the common stock. In addition, after the first issuance of the Series A Participating Preferred Stock, we cannot declare a dividend or make any distribution on the common stock unless we concurrently declare a dividend on such Series A Participating Preferred Stock. Moreover, we cannot pay dividends or make any distribution on the common stock as long as dividends payable to the Series A Participating Preferred Stock are in arrears. With respect to the Series B Preferred Stock, we cannot declare a dividend or make any distribution on the common stock unless full dividends on the Series B Preferred Stock have been paid or declared and the sum sufficient for the payment set apart.
- **Voting Rights.** Each share of Series A Participating Preferred Stock entitles its holder to 1,000 votes on all matters submitted to a vote of our stockholders. In addition, the Series A Participating Preferred and the common stock holders vote together as one class on all matters submitted to a vote of our stockholders. The holders of Series B Preferred Stock are not entitled to vote on any matter (except as provided in Delaware law in connection with amendments to our 72 charter that, among other things, would alter or change the rights and preferences of the class, in which case each share of Series B Preferred Stock would be entitled to one vote). However, the Series B Preferred Stock is convertible into common stock, and as a result, may dilute the voting power of the common stock.
- **Liquidation, Dissolution or Winding Up.** The preferred stock is entitled to certain liquidation preferences upon the occurrence of a liquidation, dissolution or winding up of our company. If there are insufficient assets or funds to permit this preferential amount, then our entire assets and all of our funds legally available for distribution will be distributed ratably among the preferred stockholders. The remaining assets, if any, will be distributed to the common stockholders on a pro rata basis.
- **Preemptive Rights.** Our Series A and Series B preferred stock do not have any preemptive rights.

WARRANTS As of December 31, 2002, Xerox owned a warrant to purchase up to a maximum of 525,732 shares of our common stock at an exercise price of \$0.61 per share.

REGISTRATION RIGHTS Prior to the filing of this prospectus, certain parties are entitled to have some of their shares of our stock registered under the Securities Act pursuant to registration rights or share purchase agreements between us and each of these parties. Specifically, Xerox has the right to register all of its 15,941,572 shares, consisting of common, preferred and warrant shares; and Merrill Lynch, Pierce Fenner & Smith Incorporated ("Merrill Lynch"), the State of Wisconsin Investment Board, and SF Capital Partners have the right to register, respectively, 65,100; 3,500,000; and 1,000,000 shares of our common stock. On a separate registration statement, we are registering 9,000,000 shares of common stock on behalf of certain of our stockholders. Of these shares, 4,500,000 shares are being registered on behalf of Xerox, 3,500,000 shares are being registered on behalf of SWIB and 1,000,000 shares are being registered on behalf of SF Capital. Each of these stockholders has agreed that it will not offer, sell or otherwise

dispose of any of our securities with respect to which it has registration rights, including the shares covered by that registration statement, for a period of 90 days after the date of this prospectus. Thomas Weisel Partners is the only party that may, in its sole discretion, modify or waive the 90-day period. Xerox Under a Registration Rights Agreement dated as of March 2, 1999 between us and Xerox, if Xerox requests that at least 10% of its registrable securities be registered, we may be required, on up to three occasions, to register Xerox's common, preferred and warrant shares for public resale. If we are eligible to file registration statements on Form S-3, Xerox may require us to register their remaining shares for public resale on Form S-3 up to two times per 12-month period. Depending on market conditions, however, we may defer such registration for up to 60 days. Furthermore, in the event we elect to register any of our shares of common stock for purposes of effecting any public offering, Xerox is entitled to include a portion of its shares of common stock in the registration, but we may reduce the number of shares proposed to be registered in view of market conditions. All expenses in connection with any registration, other than underwriting discounts and commissions, will be borne by us. Xerox's registration rights will terminate when Xerox is entitled to sell all of its shares in any 90-day period under Rule 144 of the Securities Act. 73 Merrill Lynch Under a Registration Rights Agreement between us and Merrill Lynch, upon written request, Merrill Lynch may demand to have its registrable securities registered for public resale on a Form S-3. In certain cases, we may defer such registration for up to 60 days. All registration expenses incurred in connection with our obligations under the Registration Rights Agreement will be borne by us. The registration rights of Merrill Lynch are subordinate in all respects to the registration rights of Xerox described above. Philips Under a Plan of Distribution Agreement dated January 30, 2003 between us and Philips, Philips has agreed that prior to January 30, 2004, it will not transfer or otherwise dispose of any shares of common stock it receives upon conversion of its \$27.5 million convertible debenture. After this date, Philips may provide us with notice of its desire to sell any of its shares, and we must discuss with Philips in good faith a mutually agreeable plan of distribution for the shares desired to be sold. This plan may include the registration of the shares for sale to the public or a private placement. If we cannot mutually agree on a plan of distribution, Philips may sell pursuant to Rule 144 or other applicable exemption from registration a number of shares per fiscal quarter not greater than 25% of the shares into which the convertible debenture was initially convertible. In any event, after January 30, 2004, in the event we elect to register any of our shares of common stock for purposes of effecting any public offering, Philips is entitled to include a portion of its shares of common stock in the registration, subject to reduction in certain circumstances. ANTI-TAKEOVER PROVISIONS Certain provisions of Delaware law, our Preferred Shares Rights Agreement, and our certificate of incorporation and bylaws could make the following more difficult: the acquisition of our company by means of a tender offer, or the acquisition of control of our company by means of a proxy contest or otherwise. These provisions, summarized below, are intended to discourage certain types of coercive takeover practices and inadequate takeover bids, and are designed to encourage persons seeking to acquire control of us to negotiate with our board of directors. We believe that the benefits of increased protection against an unfriendly or unsolicited proposal to acquire or restructure us outweigh the disadvantages of discouraging such proposals. Among other things, negotiation of such proposals could result in an improvement of their terms. Delaware Anti-Takeover Law. We are subject to Section 203 of the Delaware General Corporation Law, an anti-takeover law. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years following the date the person became an interested stockholder, unless the "business combination" or the transaction in which the person became an interested stockholder is approved by our board of directors in a prescribed manner. Generally, a "business combination" includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. Generally, an "interested stockholder" is a person who, together with affiliates and associates, owns or, within three years prior to the determination of interested stockholder status, did own, 15% or more of a corporation's voting stock. The existence of this provision may have an anti-takeover effect with respect to transactions not approved in advance by the board of directors, including discouraging attempts that might result in a premium over the market price for the shares of common stock held by stockholders. Preferred Shares Rights Agreement. On October 23, 1996, our board of directors adopted a resolution creating a series of preferred stock designated as Series A Participating Preferred Stock and declaring a dividend of one preferred share purchase right for each outstanding share of our common stock with each right entitling the registered holder to purchase one one-thousandth of a share of our Series A Participating Preferred Stock. The terms of the preferred share purchase rights are contained in a Preferred Share Rights Agreement. This arrangement is designed to protect and maximize the value of our outstanding equity interests in the company in the event of an unsolicited attempt by an acquiror to take 74 over our company in a manner or on terms not approved by our board. Takeover attempts frequently include coercive tactics to deprive a corporation's board of directors and its stockholders of any real opportunity to determine the direction of the corporation. The Preferred Shares Rights Agreement is aimed to deter such tactics. It may have the effect of rendering more difficult or discouraging an acquisition of our company deemed undesirable by our board, by, for example, causing substantial dilution to a person or group that attempts to acquire us on terms or in a manner not approved by our board. The preferred share purchase rights described above are triggered within ten days after the accumulation of 20% or more of our outstanding common stocks by a single acquiror or group. Our Preferred Share Rights Agreement and accompanying preferred share purchase rights do not in any way weaken the financial strength of our company or interfere with its business plans. Rather, we believe that they represent a sound and reasonable means of addressing the complex issues of corporate policy created by the current takeover environment. Additionally, they should not preclude any merger or business combination approved by our board. Other Provisions in our Charter and Bylaws. Our charter and bylaws provide other mechanisms that may help to delay, defer or prevent a change in control. For example, our charter provides that stockholders may not take action by written consent without a meeting, but must take any action at a duly called annual or special meeting. This provision makes it more difficult for stockholders to take action opposed by our board. Our charter does not provide for cumulative voting in the election of directors, which under Delaware law, precludes stockholders from cumulating their votes in the election of directors, which consequently frustrates the ability of minority stockholders to obtain representation on the board of directors. Under our charter, 24,900,000 shares of preferred stock remain undesignated. The authorization of undesignated preferred stock makes it possible for the board of directors, without stockholder approval, to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to obtain control of us (see Preferred Shares Rights Agreement discussion above). Lastly, our bylaws contain advance notice procedures which apply to stockholder proposals and the nomination of candidates for election as directors by stockholders rather than the board. TRANSFER AGENT AND REGISTRAR The transfer agent and registrar for our common stock is U.S. Stock Transfer Corporation. NASDAQ NATIONAL MARKET LISTING Our common stock is quoted on the Nasdaq National Market under the symbol

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"SSFT." On February 10, 2003, the last reported sale price of our common stock was \$4.15 per share. 75 SHARES ELIGIBLE FOR FUTURE SALE Future sales of substantial amounts of common stock, including shares issued upon exercise of outstanding options and warrants, in the public market following this offering could adversely affect market prices prevailing from time to time and could impair our ability to raise capital through sale of our equity securities. Sales of substantial amounts of our common stock in the public market after the restrictions lapse could adversely affect the prevailing market price and our ability to raise equity capital in the future. Upon completion of this offering, based upon shares outstanding as of December 31, 2002, we will have 64,422,776 outstanding shares of common stock, or 65,495,276 shares of common stock if the underwriters' over-allotment option is exercised in full, and assuming no exercise of any outstanding options or warrants. The 7,184,406 shares sold in this offering will be freely tradable without restriction under the Securities Act, unless purchased by our "affiliates," as that term is defined in Rule 144 under the Securities Act, or stockholders subject to the lock-up agreements described in the "Underwriting" section of this prospectus. We have filed a separate registration statement covering the registration on behalf of certain of our stockholders of 9,000,000 shares of our common stock. Each of these stockholders has agreed that it will not offer, sell or otherwise dispose of any of our securities with respect to which it has registration rights, including the shares covered by that registration statement, for a period of 90 days after the date of this prospectus. Thomas Weisel Partners is the only party that may, in its sole discretion, modify or waive this 90-day period. In addition, the following table shows when certain of our restricted shares may be sold in the public market pursuant to Rule 144:

DATE NUMBER OF SHARES ELIGIBLE FOR SALE COMMENT -----	
----- Current 4,791,905 shares saleable pursuant to Rule 144, subject to volume limitations 90 days after the date of this prospectus 20,441,572 shares saleable pursuant to Rule 144, subject to volume limitations 90 days after the date of this prospectus 65,100 shares saleable pursuant to Rule 144, without regard to volume limitations Generally, under Rule 144 of the Securities Act, a person who has beneficially owned restricted shares for at least one year, including persons who are affiliates, would be entitled to sell within any three-month period a number of shares that does not exceed the greater of: - 1% of our outstanding shares of common stock, which amount was 634,228 shares as of December 31, 2002; or - the reported average weekly trading volume of our common stock during the four calendar weeks preceding a sale by such person. Shares under Rule 144 are also subject to manner-of-sale provisions, notice requirements and the availability of current public information. 76 UNDERWRITING GENERAL Subject to the terms and conditions set forth in an underwriting agreement, each of the underwriters named below has severally agreed to purchase from us and the selling stockholders the aggregate number of shares of common stock set forth opposite its name below: UNDERWRITERS NUMBER OF SHARES ----- Thomas Weisel Partners LLC..... 4,669,864 Adams, Harkness & Hill, Inc..... 1,796,102 Investec Inc.....	
718,440 ----- Total.....	7,184,406 ===== Of the 7,184,406 shares to be purchased by the underwriters, 1,000,000 shares will be purchased from us and 6,184,406 will be purchased from the selling stockholders. The underwriting agreement provides that the obligations of the several underwriters are subject to various conditions, including approval of legal matters by counsel. The nature of the underwriters' obligations commits them to purchase and pay for all of the shares of common stock listed above if any are purchased. The underwriting agreement provides that we and the selling stockholders will indemnify the underwriters against certain liabilities specified in the underwriting agreement, or will contribute to payments that the underwriters may be required to make relating to these liabilities. The underwriters expect to deliver the shares of common stock to purchasers on or about February 14, 2003. OVER-ALLOTMENT OPTION We have granted a 30-day over-allotment option to the underwriters to purchase up to a total of 1,072,500 additional shares of our common stock from us at the public offering price, less the underwriting discounts payable by us, as set forth on the cover page of this prospectus. If the underwriters exercise this option in whole or in part, then each of the underwriters will be separately committed, subject to conditions described in the underwriting agreement, to purchase the additional shares of our common stock in proportion to their respective commitments set forth in the table above. COMMISSIONS AND DISCOUNTS The underwriters propose to offer the shares of common stock directly to the public at the public offering price set forth on the cover page of this prospectus, and at this price less a concession not in excess of \$0.1425 per share of common stock to other dealers specified in a master agreement among underwriters who are members of the National Association of Securities Dealers, Inc. The underwriters may allow, and the other dealers specified may re-allow, concessions, not in excess of \$0.10 per share of common stock to these other dealers. After this offering, the offering price, concessions and other selling terms may be changed by the underwriters. Our common stock is offered subject to receipt and acceptance by the underwriters and to the other conditions, including the right to reject orders in whole or in part. As consideration for services, including advice with respect to timing, size and other aspects of this offering, rendered in the distribution, Evercore Partners L.P. will be paid a fee of \$287,500 of which \$100,000 will be paid by the underwriters upon completion of the offering and \$187,500 will be paid directly by us. 77 The following table summarizes the compensation to be paid to the underwriters by us and the proceeds, before expenses, payable to us and the selling stockholder: TOTAL ----- WITHOUT OVER- WITH OVER-
PER SHARE ALLOTMENT ALLOTMENT -----	Public offering price..... \$3.8000 \$27,300,742.80
\$31,376,242.80 Underwriting discount.....	\$0.2375 \$ 1,706,296.42 \$ 1,961,015.17 Proceeds, before expenses, to us..... \$3.5625 \$
3,562,500.00 \$ 7,383,281.25 Proceeds, before expenses, to selling stockholders.....	\$3.5625 \$22,031,946.38 \$22,031,946.38
INDEMNIFICATION OF UNDERWRITERS We and the selling stockholders will indemnify the underwriters against some civil liabilities, including liabilities under the Securities Act of 1933, as amended, and liabilities arising from breaches of our representations and warranties contained in the underwriting agreement. If we or the selling stockholders are unable to provide this indemnification, we and the selling stockholders will contribute to payments the underwriters may be required to make in respect of those liabilities. NO SALES OF SIMILAR SECURITIES The underwriters will require our directors and executive officers to agree not to offer, sell, agree to sell, directly or indirectly, or otherwise dispose of any shares of common stock or any securities convertible into or exchangeable for shares of common stock without the prior written consent of Thomas Weisel Partners for a period of 180 days after the date of the initial filing of the registration statement, of which this prospectus is a part. Thomas Weisel Partners is the only party that may, in its sole discretion, modify or waive this 180-day period. Thomas Weisel Partners has no current intention to release any of these parties from its obligations under the applicable lock-up agreement or to shorten any lock-up period. Thomas Weisel Partners will only release a party from its obligations under a lock-up agreement or shorten any lock-up period if Thomas Weisel Partners determines, in its sole discretion, that such release or shortening will be in the best interests of ScanSoft and our stockholders. At this time Thomas Weisel Partners does not envisage a situation in which it would provide such a release or shortening. We	

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have agreed that for a period of 90 days after the date of this prospectus, we will not, without the prior written consent of Thomas Weisel Partners, offer, sell or otherwise dispose of any shares of common stock, or any securities exercisable for or convertible into shares of common stock, except for the shares of common stock offered in this offering, the shares of common stock issuable upon exercise of outstanding options and warrants on the date of this prospectus and the shares of our common stock that are issued under our equity compensation plans. Thomas Weisel Partners is the only party that may, in its sole discretion, modify or waive this 90-day period. Thomas Weisel Partners has no current intention to release us from our obligations under the lock-up agreement or to shorten the lock-up period. Thomas Weisel Partners will only release us from our obligations under the lock-up agreement or shorten the lock-up period if Thomas Weisel Partners determines, in its sole discretion, that such release or shortening will be in the best interests of ScanSoft and our stockholders. At this time Thomas Weisel Partners does not envisage a situation in which it would provide such a release or shortening. The previous paragraph notwithstanding, during the 90-day lock-up period we may issue shares of common stock, or securities exchangeable for or convertible into shares of common stock, solely as consideration for the acquisition (whether through merger, share purchase, share exchange or otherwise) of a company, a business, a division or assets. If the capital stock of an acquired company or of the company selling the business, division or assets is publicly traded, we may issue these securities without restriction. If the capital stock of an acquired company or of the company selling the business, division or assets is not publicly traded, the securities so issued by us shall not be freely tradable, and each recipient of the securities issued by us shall agree not to sell, agree to sell, directly or indirectly, or otherwise dispose of those securities without the consent of Thomas Weisel Partners in each case until the conclusion of the 90-day lock-up period. In connection with our filing of a separate registration statement covering the registration on behalf of certain stockholders of 9,000,000 shares of our common stock, each of those stockholders has agreed that it will not offer, sell or otherwise dispose of any of our securities with respect to which it has registration rights, including the shares covered by that registration statement, for a period of 90 days after the date of this prospectus. Thomas Weisel Partners is the only party that may, in its sole discretion, modify or waive this 90-day period. Thomas Weisel Partners has no current intention to release any of these parties from its obligations under the applicable lock-up agreement or to shorten any lock-up period. Thomas Weisel Partners will only release a party from its obligations under a lock-up agreement or shorten any lock-up period if Thomas Weisel Partners determines, in its sole discretion, that such release or shortening will be in the best interests of ScanSoft and our stockholders. At this time Thomas Weisel Partners does not envisage a situation in which it would provide such a release or shortening.

NASDAQ NATIONAL MARKET LISTING Our common stock is quoted on the Nasdaq National Market under the symbol "SSFT."

STABILIZING TRANSACTIONS AND PENALTY BIDS Until the distribution of the shares of common stock is completed, rules of the Securities and Exchange Commission may limit the ability of the underwriters to bid for and purchase our common stock. As an exception to these rules, in order to facilitate the offering, persons participating in the offering are permitted to engage in certain transactions that stabilize the price of our common stock during and after the offering. These transactions may include bids or purchases for the purpose of pegging, fixing or maintaining the price of our common stock. If the underwriters sell a larger number of shares of common stock than are set forth on the cover page of this prospectus, the underwriters may cover the sale of those additional shares by purchasing common stock in the open market. The underwriters may also elect to cover the sale of those additional shares by exercising all or part of the over-allotment option described above. In determining how to cover the sale of the additional shares, the underwriters will consider, among other things, the price of shares available in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters purchase shares in the open market in a stabilizing transaction or syndicate covering transaction, they may reclaim a selling concession from the underwriters and selling group members who sold those shares as part of this offering. Stabilization and syndicate covering transactions may cause the price of the shares to be higher than it would be in the absence of these transactions. The imposition of a penalty bid might also have an effect on the price of the shares if it discourages presales of the shares. The transactions above may occur on the Nasdaq National Market or otherwise. Neither we nor the underwriters make any representation or prediction as to the effect that the transactions described above may have on the price of the shares. If these transactions are commenced, they may be discontinued without notice at any time.

LEGAL MATTERS The validity of the shares offered hereby will be passed upon by Wilson Sonsini Goodrich & Rosati, Professional Corporation, Palo Alto, California. Katharine A. Martin, one of our directors, is a member of Wilson Sonsini Goodrich & Rosati. See Certain Relationships and Securities Transactions above. Sidley Austin Brown & Wood LLP, New York, New York, will pass upon certain legal matters in connection with this offering for the underwriters.

EXPERTS The financial statements of ScanSoft, Inc. as of December 31, 2001 and 2000 and for each of the three years in the period ended December 31, 2001 included in this Prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting. The combined balance sheets of Philips Speech Processing Telephony and Voice Control (a division of Royal Philips Electronics N.V.) as of December 31, 2001 and September 29, 2002, and the related combined statements of operations and comprehensive loss, changes in the net investment of the Philips Group, and cash flows for the year ended December 31, 2001 and the nine-month period ended September 29, 2002, appearing elsewhere herein have been included in reliance upon the report of KPMG Accountants N.V., Eindhoven, The Netherlands, independent accountants, upon the authority of said firm as experts in auditing and accounting. The financial statements of the Speech and Language Technologies operations of Lernout & Hauspie Speech Products N.V. as of September 30, 2001 and for the nine months ended September 30, 2001 included in this Prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

WHERE YOU CAN FIND MORE INFORMATION We file annual, quarterly and current reports, proxy and information statements and other information with the SEC. You can inspect and copy these reports, proxy and information statements and other information concerning ScanSoft at the SEC's public reference facilities at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549. Information on the operation of the Public Reference Room is available by calling the SEC at 1-800-SEC-0330. The SEC also maintains a site on the Web at www.sec.gov that contains reports, proxy and information statements and other information about us. This prospectus is part of a Registration Statement on Form S-1 that we filed with the SEC to register shares of our common stock. This prospectus does not contain all of the information contained in the Registration Statement. The Registration Statement together with its exhibits can be inspected and copied at the public reference facilities of the SEC referred to above.

SCANSOFT, INC. INDEX TO FINANCIAL STATEMENTS PAGE ---- CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2001 AND 2000 AND FOR THE YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999 Report of Independent Accountants..... F-2

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Consolidated Balance Sheets..... F-3 Consolidated Statements of Operations..... F-4 Consolidated Statements of Stockholders' Equity..... F-5 Consolidated Statements of Cash Flows..... F-6 Notes to Consolidated Financial Statements..... F-7 FINANCIAL STATEMENT SCHEDULE Report of Independent Accountants on Financial Statement Schedule..... F-32 Schedule II -- Valuation and Qualifying Accounts and Reserves..... F-33 UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002 AND DECEMBER 31, 2001 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001 Consolidated Balance Sheets (Unaudited)..... F-35 Consolidated Statements of Operations (Unaudited)..... F-36 Consolidated Statements of Cash Flows (Unaudited)..... F-37 Notes to Unaudited Consolidated Financial Statements..... F-38 COMBINED FINANCIAL STATEMENTS OF THE PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL DIVISION OF ROYAL PHILIPS ELECTRONICS N.V. Independent Auditors' Report..... F-49 Combined Balance Sheets..... F-50 Combined Statements of Operations and Comprehensive Loss..... F-51 Changes in the Net Investment of the Philips Group..... F-52 Combined Statements of Cash Flows..... F-53 Notes to the Combined Financial Statements..... F-54 FINANCIAL STATEMENTS OF THE SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. Report of Independent Accountants..... F-71 Statement of Assets and Liabilities as of September 30, 2001..... F-72 Statement of Revenue and Direct Operating Expenses for the Nine Months Ended September 30, 2001..... F-73 Notes to Financial Statements..... F-74 UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS Introduction to the Unaudited Pro Forma Combined Financial Statements..... F-83 Unaudited Pro Forma Combined Balance Sheet as of September 30, 2002..... F-84 Unaudited Pro Forma Combined Statement of Operations for the Year Ended December 31, 2001..... F-85 Unaudited Pro Forma Combined Statement of Operations for the Nine Months Ended September 30, 2002..... F-86 Notes to Unaudited Pro Forma Combined Financial Statements..... F-87 F-1 REPORT OF INDEPENDENT ACCOUNTANTS To the Board of Directors and Stockholders of ScanSoft, Inc: In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of ScanSoft, Inc. and its subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. /s/ PricewaterhouseCoopers LLP Boston, Massachusetts February 11, 2002, except as to Note 15 for which the date is March 5, 2002 F-2 SCANSOFT, INC. CONSOLIDATED BALANCE SHEETS DECEMBER 31, ----- 2001 2000 ----- (IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS) ASSETS Current assets: Cash and cash equivalents..... \$ 14,324 \$ 2,571 Short-term investments..... -- 62 Accounts receivable, less allowances of \$6,273 and \$7,375, respectively..... 12,464 6,727 Receivables from related party (Note 13)..... 1,802 1,587 Inventory..... 507 806 Prepaid expenses and other current assets..... 1,614 1,610 ----- Total current assets..... 30,711 13,363 Goodwill and other intangible assets, net..... 108,532 92,051 Property and equipment, net..... 2,150 2,954 Other assets..... 677 1,112 ----- Total assets..... \$ 142,070 \$ 109,480 ===== LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable..... \$ 5,320 \$ 7,945 Accrued expenses..... 14,471 7,418 Deferred revenue..... 1,375 1,084 Short-term bank borrowings..... -- 3,400 Note payable..... 227 -- ----- Total current liabilities..... 21,393 19,847 Deferred revenue..... 2,534 2,172 Long-term note payable, net of current portion..... 3,273 -- Other liabilities..... 336 -- ----- Total liabilities..... 27,536 22,019 ----- Commitments and contingencies (Notes 5, 7 and 11) Stockholders' equity: Preferred stock, \$0.001 par value; 40,000,000 shares authorized; 3,562,238 shares issued and outstanding (liquidation preference \$4,631)..... 4,631 4,631 Common stock, \$0.001 par value; 140,000,000 shares authorized; 62,754,211 and 46,072,748 shares issued and 62,098,211 and 46,072,748 shares outstanding, respectively..... 63 46 Additional paid-in capital..... 264,893 219,259 Treasury stock at cost (656,000 and no shares, respectively)..... (1,031) -- Deferred compensation..... (276) -- Accumulated other comprehensive loss..... (487) (93) Accumulated deficit..... (153,259) (136,382) ----- Total stockholders' equity..... 114,534 87,461 ----- Total liabilities and stockholders' equity..... \$ 142,070 \$ 109,480 ===== The accompanying notes are an integral part of these consolidated financial statements. F-3 SCANSOFT, INC. CONSOLIDATED STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, ----- 2001 2000 1999 ----- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) Revenue, third parties..... \$ 56,647 \$ 43,071 \$ 26,933 Revenue, related party..... 7,208 5,984 4,696 ----- Total revenue..... 63,855 49,055 31,629 ----- Costs and expenses: Cost of revenue..... 12,849 12,692 7,602 Cost of revenue from amortization of intangible assets.... 14,192 11,569 1,405 Research and development..... 13,968 14,967 6,920 Selling, general and administrative..... 26,449 28,205 14,509 Amortization of goodwill and other intangible assets..... 13,328 11,017 516 Restructuring and other charges, net..... -- 4,811 346 Acquired in-process research and development..... -- 18,291 3,944 ----- Total costs and expenses..... 80,786 101,552 35,242 ----- Loss from operations..... (16,931) (52,497) (3,613) Other income (expense): Interest income..... 209 112 181 Interest expense..... (166) (620) (56) Other (expense) income, net..... (306) 226 8 Gain on sale of hardware business..... -- -- 882 -----

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OF CASH FLOW INFORMATION Cash paid during the year for interest..... \$ 135 \$ 635 \$ -- The accompanying notes are an integral part of these consolidated financial statements. F-6 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 1. ORGANIZATION AND PRESENTATION ScanSoft, Inc. was incorporated as Visioneer, Inc. in March 1992 and through December 1998, developed and sold scanner hardware and software products. On January 6, 1999, Visioneer sold the hardware business and the Visioneer brand name to Primax Electronics, Ltd., and on March 2, 1999, Visioneer acquired ScanSoft, in a cash election merger, from Xerox Corporation. The corporate entity "Visioneer" survived the merger, but changed its name to "ScanSoft, Inc." In addition, Visioneer changed the ticker symbol for its common stock that trades on the Nasdaq, to "SSFT." On March 13, 2000, the Company merged with Caere Corporation ("Caere"), a California-based digital imaging software company. The acquisitions of ScanSoft and Caere were accounted for under the purchase method of accounting and, accordingly, the results of operations of ScanSoft and Caere have been included in the Company's financial statements as of the acquisition dates. When we refer to "we" or "ScanSoft" or "the Company," we mean the current Delaware corporation ScanSoft, Inc., including all of its consolidated subsidiaries. ACCOUNTING FOR ACQUISITION On December 12, 2001, the Company acquired certain assets of Lernout & Hauspie Speech Products N.V. and certain of its affiliates. On December 27, 2001, the Company filed a Form 8-K reporting the transaction as an acquisition of assets. The Company had ongoing discussions with the SEC regarding historical financial statement requirements related to the acquisition. Following these discussions, the Company concluded that, for purposes of Rule 3-05 of Regulation S-X, the L&H transaction was an acquisition of a business and not an acquisition of assets. In connection with these discussions, the Company also concluded that the transaction should be reported as an acquisition of a business for accounting purposes rather than an acquisition of assets, as previously reported. On August 14, 2002, the Company filed a Form 10-Q/A to restate the financial statements as of and for the quarter ended March 31, 2002 to reflect the impact of the change in the accounting for the acquisition. The change in the accounting for the transaction was determined to have an immaterial impact on the financial position, results of operations or cash flows of the Company for the year ended December 31, 2001. The change in accounting for the transaction resulted in a reallocation of the purchase price from amortizable intangible and tangible assets to goodwill. The following summarizes the impact of the reallocation of the purchase price (in 000's):

	DECEMBER 31, 2001	AS PREVIOUSLY REPORTED	AS REVISED
Balance Sheet: Goodwill, net.....	\$ 42,169	\$ 65,231	
Other intangible assets, net.....	66,107	43,301	
Property and equipment, net.....	2,406	2,150	
Total goodwill, other intangible assets and property and equipment, net.....	\$110,682	\$110,682	

ACQUISITION OF LERNOUT & HAUSPIE (L&H) SPEECH PRODUCTS N.V. ASSETS On December 7, 2001, the Company entered into a definitive asset purchase agreement (the "Purchase Agreement") to acquire certain assets and intellectual property relating to the former L&H entities that were in bankruptcy under the jurisdiction of both the United States Bankruptcy Court for the F-7 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) District of Delaware and the Belgium Court of Ieper. We purchased these assets in a closed auction proceeding approved by both the United States and Belgium courts on December 11, 2001. The transaction was completed on December 12, 2001. Pursuant to the Purchase Agreement, the Company acquired patents, trademarks, tradenames, product and customer contracts associated with certain of the speech and language technology assets of L&H. In addition, the Company also obtained rights to accounts receivable related to the customer contracts acquired and fixed assets. The Company also hired 223 employees from L&H. The Company paid \$41.3 million in total consideration to the creditors as follows: \$10.0 million in cash, 7.4 million shares of the Company's common stock valued at \$27.8 million (based on the average of the closing share price of our stock 3 days before and after the proposed acquisition was announced) and a 9% promissory note in the principal amount of \$3.5 million, to be repaid in installments of \$0.1 million of principal and interest quarterly commencing on March 15, 2002, for a total of eleven (11) payments. All remaining principal and interest shall become due on December 15, 2004. With the acquisition of certain of L&H's assets in December 2001, ScanSoft added speech and language solutions to its portfolio of productivity-enhancing applications and technologies. The group of assets acquired includes the RealSpeak text-to-speech technology, Dragon speech recognition software and other speech and voice-related technologies aimed at the rapidly growing telecommunications, automotive and mobile device markets. ScanSoft believes that its speech-based technology and intellectual property is widely considered the finest in the industry. The Company generated \$10.4 million of cash from operations for 2001 and had a cash balance of \$14.3 million at December 31, 2001. The Company's cash balance reflects lower operating expenses as a result of restructuring actions and other cost reduction initiatives, taken in fiscal 2000, higher revenues compared to fiscal 2000 and equity financings net of cash paid for the L&H acquisition. The Company expects that operating expenses will increase in 2002 as a result of the L&H acquisition. While the Company believes its revenues will also increase and therefore its cash flows from operations, cash generated from operations could be negatively impacted if the Company's products are not accepted in the markets in which it does business, by seasonality of customer buying patterns or by a continued or worsened economic downturn in the United States or international markets where its products are sold. There can be no assurance that the Company will be able to continue to generate cash from operations or secure additional equity financing if required. The Company has sustained recurring losses and has an accumulated deficit at December 31, 2001. The Company believes that operating expense levels in combination with expected future revenues will continue to generate positive cash flows from operations. The Company also believes that, should it experience any of the aforementioned factors, it has the ability to reduce operating expenses to levels commensurate with revenues to maintain positive cash flows from operations. The Company believes that cash flows from future operations in addition to cash on hand will be sufficient to meet its working capital, investing, financing and contractual obligations as they become due for the foreseeable future including stock repurchase programs and potential business or asset acquisitions. 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES BASIS OF PRESENTATIONS The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities on the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. The most significant estimates included in the financial statements are accounts receivable and sales allowances, the recoverability of F-8 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) intangible assets including goodwill and the valuation allowances on deferred tax assets. Actual results could differ from those estimates. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany transactions and balances have been eliminated. FOREIGN CURRENCY TRANSLATION The functional currency of the Company's foreign subsidiaries is the local currency. Assets and liabilities of foreign

subsidiaries that are denominated in foreign currencies are translated into United States dollars at exchange rates in effect at the balance sheet date. Revenue and expense items are translated using the average exchange rates for the period. Net unrealized gains and losses resulting from foreign currency translation are included in other comprehensive loss, which is a separate component of stockholders' equity. Foreign currency transaction gains and losses are included in results of operations. The Company reported foreign currency transaction gains and (losses) of \$0.2 million, \$(0.1) million and zero for the years ended 2001, 2000 and 1999, respectively.

REVENUE RECOGNITION The Company derives revenues from the sale of its software products to end-users through distribution partners and value added resellers (VARs), royalties received from OEM partners, license fees from sales of its products to end-users and from services, primarily maintenance associated with software license transactions. The Company applies the provisions of Statement of Position 97-2 Software Revenue Recognition, as amended by Statement of Position 98-9 Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions, to all transactions involving the sale of software products. In addition, the Company applies the provisions of Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements. Accordingly, provided that the fee is fixed or determinable and collection of the receivable is reasonably assured, the Company generally recognizes revenue from sales of its software products upon receipt of evidence of the arrangement and upon product shipment or deployment, except for shipments to a distributor or reseller. Under the terms of our agreements with distributors and authorized resellers (including VARs), title and risk-of-loss pass to the customer upon shipment, at which time the transaction is invoiced and payment is due. Agreements provide distributors and resellers rights of return. As a result, the Company recognizes revenue from sales to distributors and resellers only upon sale of the products by the distributor or reseller to retailers or end-users. Based on reports from distributors and resellers of their inventory balances at the end of each period, the Company records an allowance against accounts receivable for the sales price of all inventory subject to return. In addition, the Company records reserves for estimated sales returns by retailers and end-users to it directly or through the Company's distributors or resellers based historical returns experience. The provision for these estimated returns is recorded as a reduction of revenue at the time that the related revenue is recorded. Such returns from retailers and end-users have not been significant. Also, from time to time, the Company offers its customers rebates or offers price protection incentive programs to retailers for the sale of the Company's products. The Company estimates the impact on revenue of rebate or price protection programs based upon its historical experiences with similar programs for like products. The estimated reserve for such rebates or programs is recorded as a reduction of revenue in the period when the rebate or price protection program is available to the end-user or retailer. The Company also receives royalties from agreements with original equipment manufacturers (OEMs). Under the terms of its OEM licensing agreements, the Company ships a master disk to the F-9

SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) OEM and permits the OEM to make multiple copies. Royalty payments are due to the Company upon the OEM's deployment of copies of licensed software. Accordingly, revenue from royalty fees is recognized when copies are deployed and payment is due. The Company recognizes royalty revenue from OEMs for which the Company has significant historical experience based on estimates of deployments in the current period. The Company bases its estimates on timely, informal communication with the OEM and the OEM's past royalty reporting and payment history, the seasonality of its business, the number of copies deployed in previous periods, and the overall economic environment in which the OEM is operating. Differences between the Company's estimates and the actual copies deployed in the period are recorded as an adjustment to revenue in the period that they become known, generally one quarter later. The Company has not experienced significant differences between its estimated and actual deployments for any period presented. The Company applies the residual method to account for revenues when an order contains one or more elements to be delivered in the future (for example, maintenance and support services or training) and when evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements is initially deferred and the remaining portion of the arrangement fee is recognized as revenues related to the delivered elements. If evidence of the fair value of one or more of the undelivered elements does not exist, all revenues are deferred and recognized only when delivery of those elements occurs or when fair value can be established. Vendor-specific objective evidence (VSOE) of the fair value of each undelivered element is based on the prices charged by the Company to its customers when these elements are sold separately or, in the case of some maintenance services, based on the contractual maintenance renewal rates. VSOE of the fair value of training service is based on the fee charged per day or per student, depending on the type of training provided. The Company recognizes revenue from the sale of maintenance and support to end-users ratably over the contract period, usually one year. Payments received in advance for maintenance and support revenue are initially recorded as deferred revenue. Revenue from training service is recognized as it is provided. The Company's products do not require installation or implementation by the Company and do not require significant production, modification or customization of the software. However, the Company occasionally enters into software license agreements with customers that require significant modification of the software. Revenue is recognized under these arrangements in accordance with Statement of Position 81-1 (SOP 81-1), Accounting for Performance of Construction-Type and Certain Performance-Type Contracts. Under the percentage-of-completion method, the Company determines progress toward completion based on costs incurred to date as compared with total estimated costs at the contract completion date. Anticipated losses, if any, are recognized in the period in which determined.

CASH EQUIVALENTS Cash equivalents are short-term, highly liquid instruments with original maturities of 90 days or less at the date of acquisition. The Company invests primarily in commercial paper. **INVENTORY** Inventory is stated at the lower of cost (determined on a first-in, first-out basis) or market value. Costs incurred related to shipping and handling of our inventory and products are recorded as a cost of revenue. **PROPERTY AND EQUIPMENT** Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the term of the related lease or the useful life, if shorter. The cost and related accumulated depreciation of sold or retired assets F-10

SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) are removed from the accounts and any gain or loss is included in operations. Repairs and maintenance costs are expensed as incurred. **INTANGIBLE ASSETS** Intangible assets result from acquisitions that were accounted for under the purchase method of accounting and consist of the values of identifiable intangible assets including core technology, patents, trade names, trademarks, OEM relationships, work force and registered users base, as well as goodwill. Goodwill is the amount by which the cost of acquired net assets exceeded the fair values of those net assets on the purchase date. Intangible assets are reported at cost, net of accumulated amortization. Intangible assets are amortized on a straight-line basis over their estimated useful lives of three to seven years. The Company evaluates its intangible assets when events and circumstances indicate a potential impairment. Recoverability of these assets is assessed based on

undiscounted expected cash flows from these assets, considering a number of factors, including past operating results, budgets and economic projections, market trends and product development cycles. An impairment in the carrying value of each asset is assessed when the undiscounted expected cash flows derived from the asset are less than its carrying value (see Note 11).

RESEARCH AND DEVELOPMENT COSTS Costs incurred in the research and development of new software products and enhancements to existing products, other than certain software development costs that qualify for capitalization, are expensed as incurred. Software development costs incurred subsequent to the establishment of technological feasibility, but prior to the general release of the product, are capitalized and amortized to cost of revenue over the estimated useful life of the related products. In the years ended December 31, 2001, 2000 and 1999, costs eligible for capitalization were not material.

INCOME TAXES Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. A valuation allowance against deferred tax assets is recorded if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company does not provide for United States income taxes on the undistributed earnings of its foreign subsidiaries, which the Company considers to be permanent investments.

COMPREHENSIVE LOSS Comprehensive loss consists of net loss and other comprehensive loss, which includes foreign currency translation adjustments. For the purposes of comprehensive loss disclosures, the Company does not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as the Company intends to permanently reinvest undistributed earnings in its foreign subsidiaries.

CONCENTRATION OF RISK Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash equivalents, and trade accounts receivable. The Company places its cash and cash equivalents with financial institutions with high credit ratings. The Company performs ongoing credit evaluations of its customers' financial condition and does not require collateral, since management does not anticipate nonperformance of payment. The Company also maintains reserves for potential credit losses and such losses have been within management's expectations. At December 31, 2001, three customers represented 16%, 13% and 11%, of our net accounts receivable balance, respectively. At December 31, 2000, two customers in aggregate accounted for 50%, of our net accounts receivable balance.

F-11 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) FAIR VALUE DISCLOSURES OF FINANCIAL INSTRUMENTS Financial instruments include cash equivalents, accounts receivable, short-term bank borrowings and long-term notes payable and are carried in the financial statements at amounts that approximate their fair value as of December 31, 2001 and 2000.

ADVERTISING COSTS Advertising costs are expensed as incurred and are classified as selling, general and administrative costs. The Company reported advertising costs of \$2.5 million, \$1.9 million and \$1.0 million for the years ended December 31, 2001, 2000 and 1999, respectively.

NET LOSS PER SHARE Basic loss per share is based on the weighted average number of common shares outstanding excluding unvested restricted stock, and diluted loss per share is based on the weighted average number of common shares outstanding and dilutive potential common shares outstanding. Potential common shares result from the assumed exercise of outstanding stock options and warrants as well as unvested shares of restricted stock and conversion of Series B Preferred Stock, the proceeds of which are then assumed to have been used to repurchase outstanding common stock using the treasury stock method. There is no difference between basic and diluted net loss per share for all periods presented since potential common shares were anti-dilutive for all periods presented. Potential common shares, including stock options, unvested restricted stock, preferred shares and warrants at December 31, 2001, 2000 and 1999 were approximately 17,450,100, 16,428,900 and 8,009,700, respectively.

ACCOUNTING FOR STOCK-BASED COMPENSATION The Company accounts for stock-based awards to employees using the intrinsic value method as prescribed in Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. The Company follows the disclosure provisions of Statement of Accounting Standards ("SFAS") No. 123, Accounting for Stock-Based Compensation (see Note 6). Deferred compensation is recorded for restricted stock granted to employees based on the fair value of the Company's common stock at the date of grant and is amortized over the period in which the restrictions lapse. All stock-based awards to non-employees are accounted for at their fair value in accordance with SFAS No. 123 and related interpretations.

RECENTLY ISSUED ACCOUNTING STANDARDS In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141 ("SFAS 141"), Business Combinations and No. 142 ("SFAS 142"), Goodwill and Other Intangible Assets. SFAS 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets, including how goodwill and other intangible assets should be accounted for after they have been initially recognized. In addition, SFAS 142 includes provisions for the reclassification of certain existing recognized intangible assets, such as acquired workforce, into goodwill. SFAS 142 provides that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment; intangible assets with finite useful lives will continue to be amortized over their useful lives. SFAS 142 also provides specific guidance for testing goodwill for impairment. In accordance with its provisions, the Company will adopt SFAS 142 on January 1, 2002 and will cease amortizing goodwill; the Company had previously been recording annual goodwill amortization of approximately \$10.1 million. The Company will also reclassify approximately \$0.1 million of previously recognized acquired workforce to goodwill and as a result, amortization on this amount has also ceased. SFAS 142 also requires the Company to complete a transitional goodwill impairment test within six F-12

SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) months from the date of adoption. The Company currently does not expect to record an impairment charge on the \$65.2 million of goodwill at December 31, 2001, upon completion of the initial impairment review. The decrease in amortization expense from the goodwill will be partly offset in 2002 by the amortization of intangible assets acquired from L&H of approximately \$2.0 million per year. The Company estimates total amortization expense for 2002 will be approximately \$11.2 million. In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). The objectives of SFAS 144 are to address significant issues relating to the implementation of FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of ("SFAS 121"), and to develop a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. SFAS 144 supersedes SFAS 121; however, it retains the fundamental provisions of SFAS 121 for (1) the recognition and measurement of the impairment of long-lived assets to be held and used and (2) the measurement of long-lived assets to be disposed of by sale. SFAS 144 supersedes the accounting and reporting provisions of Accounting

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Principles Board No. 30, Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions ("APB 30"), for segments of a business to be disposed of. However, SFAS 144 retains the requirement of APB 30 that entities report discontinued operations separately from continuing operations and extends that reporting requirement to "a component of an entity" that either has been disposed of or is classified as "held for sale." SFAS 144 also amends the guidance of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to eliminate the exception to consolidation for a temporarily controlled subsidiary. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, including interim periods, and, generally, its provisions are to be applied prospectively. The Company does not expect that the initial application of SFAS 144 will have a material impact on its financial position or results of operations. In November 2001, the Emerging Issues Task Force ("EITF"), a committee of the FASB, reached a consensus on EITF Issue 01-9, Accounting for Consideration Given by a Vendor to a Customer or Reseller of the Vendor's Products ("EITF 01-9"). EITF 01-9 presumes that consideration from a vendor to a customer or reseller of the vendor's products is a reduction of the selling prices of the vendor's products and, therefore, should be characterized as a reduction of revenue when recognized in the vendor's income statement and could lead to negative revenue under certain circumstances. Revenue reduction is required unless consideration relates to a separate identifiable benefit and the benefit's fair value can be established, in which case such amounts may be recorded as operating expenses. In accordance with its provisions, the Company will adopt EITF 01-9 on January 1, 2002. Certain of its co-operative marketing and marketing development fund programs do not meet the criteria to be recorded as operating expenses, which is the current policy. Unless the Company is able to renegotiate or otherwise change these marketing programs with its retailers, amounts earned by the retailers under such programs will be recorded as revenue reductions in the future. Upon adoption, the Company will reclassify all prior period reported results of operations to conform to the presentation required by EITF 01-9. The Company is currently assessing the impact of EITF 01-9 on its previously reported revenue and operating expenses. EITF 01-9 will not impact its overall results of operations. F-13

SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 3. BALANCE SHEET COMPONENTS

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

	DECEMBER 31, 2001	2000
Inventory: Raw materials.....	\$ 107	\$ 324
Finished goods.....	400	482
Goodwill and other intangible assets (see Note 11): Goodwill.....	\$ 83,509	\$ 60,447
Patents and core technology.....	46,456	28,586
Completed technology.....	16,340	16,340
Trademarks.....	7,461	4,383
Non-competition agreement.....	4,048	4,048
Acquired favorable lease.....	553	553
OEM relationships.....	1,100	1,100
Assembled workforce.....	923	200
Accumulated amortization.....	(51,509)	(24,529)
Accrued expenses: Accrued compensation.....	\$ 2,775	\$ 1,188
Accrued sales and marketing incentives.....	1,160	1,880
Accrued restructuring.....	634	1,428
Accrued royalties.....	750	650
Accrued professional fees.....	571	638
Accrued acquisition liabilities.....	6,065	--
Accrued transaction costs.....	882	--
Accrued taxes and other.....	1,634	1,634
Property and equipment: Computers, software and equipment.....	3	\$6,300
Leasehold improvements.....	2-4	436
Furniture and fixtures.....	3	193
Construction in process.....	--	176
Accumulated depreciation.....	7,105	6,430
	(4,955)	(3,476)

F-14 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Depreciation expense, associated with property and equipment, for the years ended December 31, 2001, 2000 and 1999 was \$1.8 million, \$2.1 million, and \$0.2 million, respectively. 4. DEBT On March 14, 2000, the Company entered into a one year Credit Agreement (the "Agreement") with its primary financial institution for a \$10,000,000 revolving loan (the "Credit Facility"). Borrowings under the Credit Facility bore interest at the prime rate plus one percent and, as amended, expired on September 30, 2001. The maximum aggregate amount of borrowings outstanding at any one time as amended was \$5.0 million. During 2001, the Company repaid all amounts due under the Credit Facility, which included principal and interest amounting to \$3.4 million. The Credit Facility was terminated and cancelled upon the final payment. PROMISSORY NOTES PAYABLE In connection with the L&H acquisition, the Company issued a \$3.5 million promissory note (the "Note") to L&H. The unsecured Note, matures on December 15, 2004 and bears interest at 9% per annum. Payments of principal and interest in the amount of \$133,000 are due quarterly commencing on March 15, 2002, for a total of eleven (11) payments. All remaining principal and interest is due on December 15, 2004. Principal payments due under the Note are as follows: \$0.2 million in 2002, \$0.2 million in 2003, and \$3.1 million in 2004.

5. STOCKHOLDERS' EQUITY PREFERRED STOCK The Company is authorized to issue up to 40,000,000 shares of preferred stock, par value \$0.001 per share. The Company has designated 100,000 shares as Series A Preferred Stock and 15,000,000 as Series B Preferred Stock. In connection with the acquisition of ScanSoft (see Note 11), the Company issued 3,562,238 shares of Series B Preferred Stock to Xerox Corporation ("Xerox"). The Series B Preferred Stock is convertible into shares of common stock on a one-for-one basis. The Series B Preferred Stock has a liquidation preference of \$1.30 per share plus all declared but unpaid dividends. The Series B Preferred Stock holders are entitled to non-cumulative dividends at the rate of \$0.05 per annum per share, payable when, as and if declared by the Board of Directors. To date no dividends have been declared by the Board of Directors. Holders of Series B Preferred Stock have no voting rights, except those rights provided under Delaware law. The undesignated shares of preferred stock will have rights, preferences, privileges and restrictions, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences, as shall be determined by the Board of Directors upon issuance of the preferred stock. The Company has reserved 3,562,238 shares of its common stock for issuance upon conversion of the Series B Preferred Stock. COMMON STOCK WARRANTS In connection with the ScanSoft acquisition in 1999 (see Note 11), the Company issued employee stock options for the purchase of 1,736,630 shares of common stock in exchange for Xerox stock options previously held by the employees. Also in connection with the acquisition of ScanSoft, the Company issued to Xerox a ten-year warrant that allows Xerox to acquire a number of shares of common stock equal to the number of stock options (whether vested or unvested) that remains unexercised at the expiration of any ScanSoft employee stock option issued by the Company in the merger. The exercise price for each warrant share is \$0.61. If all of the assumed ScanSoft

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assumptions: expected volatility of 130% for 2001 and 2000, and 209% for 1999, risk-free interest rate of 3.66% to 4.97% for options granted in 2001, 5.02% to 6.68% for options granted in 2000, and 5.36% to 6.07% for options granted in 1999, and a weighted average expected option term of 5 years for all periods. The Company has not paid dividends to date and assumed no dividend yield. For the Employee Stock Purchase Plan, the fair value of each purchase right was estimated at the beginning of the offering period using the Black-Scholes option-pricing model with the following assumptions used in 2001, 2000 and 1999: expected volatility of 133% to 168% for 2001, 128% for 2000 and 100% to 130% for 1999; risk-free interest rate of 3.41% to 5.04%, 6.10% and 5.03% for 2001, 2000 and 1999, respectively; and expected lives of six months for all three years. The Company has not paid dividends and assumed no dividend yield. The weighted-average fair value of all purchase rights granted in 2001, 2000 and 1999, were \$1.04, \$1.73 and \$0.66, respectively.

F-18 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 7. COMMITMENTS AND CONTINGENCIES OPERATING LEASES The Company has various operating leases for office space around the world. These obligations extend through 2008. Future minimum payments under operating leases with an initial term of more than one year are as follows (in thousands):

YEAR ENDING DECEMBER 31, -----	
2002.....	\$1,736
2003.....	1,820
2004.....	1,779
2005.....	1,767
2006.....	1,408
Thereafter.....	400
----- Total.....	\$8,910

==== Total rent expense under operating leases for the years ended December 31, 2001, 2000 and 1999 was \$0.8 million, \$0.8 million and \$0.3 million, respectively. LITIGATION AND OTHER CLAIMS Like many companies in the software industry, we have from time to time been notified of claims that we may be infringing certain intellectual property rights of others. These claims have been referred to counsel, and they are in various stages of evaluation and negotiation. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. We can give no assurance that licenses will be offered by all claimants, that the terms of any offered licenses will be acceptable to us or that in all cases the dispute will be resolved without litigation, which may be time consuming and expensive, and may result in injunctive relief or the payment of damages by us.

In January 2002, ScanSoft received notice that the Massachusetts Institute of Technology and Electronics For Imaging, Inc. had filed a patent infringement claim against 94 defendants including ScanSoft. Damages are sought in an unspecified amount. To date, we have not yet been served with the court documents. We cannot predict the outcome of the claim, nor can we make any estimate of the amount of damages, if any, for which we will be held responsible in the event of a negative conclusion of the claim. On August 16, 2001, ScanSoft was sued by Horst Froessler for patent infringement. Damages are sought in an unspecified amount. We filed an Answer and Counterclaim on September 19, 2001. We believe this claim has no merit and we intend to defend the action vigorously. The Company believes that the final outcome of such matters will not have a significant adverse effect on the Company's financial position and results of operations, including the expenditure of a significant amount of resources defending such claims. However, should the Company not prevail in any such litigation, its operating results and financial position could be adversely impacted.

8. 401(K) SAVINGS PLAN The Company has established a retirement savings plan under Section 401(k) of the Internal Revenue Code (the "401(k) Plan"). The 401(k) Plan covers substantially all employees of the Company who meet minimum age and service requirements, and allows participants to defer a portion of their annual compensation on a pre-tax basis. The Company contributes in cash, 100% of up to the first 4% of an employee's salary contributed to the 401(k) Plan by the employee. The Company's contributions to the 401(k) Plan totaled \$0.4 million, \$0.4 million and \$0.3 million for the years ended December 31, 2001, 2000 and 1999, respectively.

9. SEGMENT, GEOGRAPHIC AND SIGNIFICANT CUSTOMER INFORMATION The Company operates in a single segment. The following table presents total revenue information by geographic area (in thousands):

YEAR ENDED DECEMBER 31, -----	
2001 2000 1999 -----	United States.....
\$50,405 \$39,965 \$24,732	Other foreign countries.....
	13,450 9,090 6,897 -----
Total.....	\$63,855 \$49,055 \$31,629

==== Revenue classification above is based on the country in which the sale originates or is invoiced. Revenue in other countries predominately relates to sales to customers in Europe. Intercompany sales are insignificant as products sold in other countries are sourced within Europe. A number of the Company's North American OEM partners distribute its products throughout the world but because its partners do not provide the geographic dispersion of its products it has recognized the revenue in the United States. The following table summarizes the Company's long-lived assets, excluding intangible assets, by geographic location (in thousands):

DECEMBER 31, -----	
2001 2000 -----	United States.....
\$2,165 \$3,505	Other foreign countries.....
662 561 -----	\$2,827 \$4,066

==== In 2001, three customers accounted for 28%, 15% and 11% of total net revenues. During 2000, three customers accounted for 27%, 11% and 12% of total revenues. During 1999, three customers accounted for 24%, 15% and 15% of total revenues. 10. INCOME TAXES The components of the income tax provision (benefit) are as follows (in thousands):

YEAR ENDED DECEMBER 31, -----	
2001 2000 1999 -----	Federal.....
\$ (16) \$ -- \$ 70	Foreign.....
277 382 60	State.....
(578) 90 20 -----	Provision (benefit) for income taxes.....
	\$(317) \$472 \$150

==== F-20 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) For financial reporting purposes, loss before income taxes includes the following components (in thousands):

YEAR ENDED DECEMBER 31, -----	
2001 2000 1999 -----	United States.....
\$(17,797) \$(53,609) \$(2,756)	Foreign.....
603 830 158 -----	Total.....
	\$(17,194) \$(52,779) \$(2,598)

==== The cumulative amount of undistributed earnings of foreign subsidiaries, which is intended to be permanently reinvested and for which United States income taxes have not been provided, totaled approximately \$1.2 million at December 31, 2001.

Deferred tax assets (liabilities) consist of the following (in thousands):

DECEMBER 31, -----	
2001 2000 -----	Deferred tax assets Net operating loss carryforwards.....
\$ 36,439 \$ 40,450	Federal and state credit carryforwards.....
4,011 3,213	Capitalized start-up and development costs.....
1,108 1,091	Accrued expense and other reserves.....
3,374 4,007	Deferred revenue.....
1,136 1,136	Depreciation.....
1,960 1,697	Other.....
4 5	

48,032 51,599	Deferred tax liabilities Acquired intangibles.....
(7,767) (14,622)	Valuation allowance.....
(40,265) (36,977) -----	Net deferred tax assets.....
	\$ -- \$ --

==== At December 31, 2001 and 2000, the Company provided a valuation allowance for the full amount of its net deferred

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tax assets due to the uncertainty of realization of those assets as a result of the recurring and cumulative losses from operations. The Company monitors the realization of its deferred tax assets based on changes in circumstances, for example, recurring periods of income for tax purposes following historical periods of cumulative losses or changes in tax laws or regulations. At such time that changes occur which will result in a change in the estimate of the valuation allowance, an income tax benefit would be recorded in the results of operations to reduce the valuation allowance. F-21 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) A reconciliation of the Company's effective tax rate to the statutory federal rate is as follows: YEAR ENDED DECEMBER 31, ----- 2001 2000 1999 ----- Federal statutory tax rate..... (34.0)% (34.0)% (34.0)% Nondeductible amortization and in-process research and development..... 20.0 5.3 51.6 Foreign taxes..... (0.4) 0.4 2.3 State tax, net of federal benefit..... (4.4) 0.1 0.5 Other..... 0.5 -- -- Change in valuation allowance..... 16.5 29.1 (14.6) ----- (1.8)% 0.9% 5.8% ===== At December 31, 2001 and 2000, the Company had federal net operating loss carryforwards of approximately \$90 million and \$105 million, respectively, of which approximately \$4.1 million and \$2.8 million, respectively, relate to tax deductions from stock compensation. The tax benefit related to the stock compensation, when realized, will be accounted for as additional paid-in capital rather than as a reduction of the provision for income tax. At December 31, 2001 the Company had federal and state research and development credit carryforwards of approximately \$2.8 million and \$1.6 million respectively. The net operating loss and credit carryforwards will expire at various dates through 2021, if not utilized. Utilization of the net operating losses and credits may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization. 11. ACQUISITIONS ACQUISITION OF L&H ASSETS On December 7, 2001, the Company entered into a definitive asset purchase agreement (the "Purchase Agreement") to acquire certain assets and intellectual property relating to the former L&H entities that were in bankruptcy under the jurisdiction of both the United States Bankruptcy Court for the District of Delaware and the Belgium Court of Ieper. We purchased these assets in a closed auction proceeding and approved by both the United States and Belgium courts on December 11, 2001. The transaction was completed on December 12, 2001 and the Company's results from operations include L&H activities since that date. Pursuant to the Purchase Agreement, the Company acquired patents, trademarks, tradenames, product and customer contracts associated with certain of the speech and language technology assets of L&H. In addition, the Company obtained rights to accounts receivable related to the customer contracts acquired and fixed assets. The Company also hired 223 employees from L&H. The Company paid \$41.3 million in total consideration to the creditors as follows: \$10.0 million in cash, 7.4 million shares of the Company's common stock valued at \$27.8 million (based on the average of the closing share price of our stock 3 days before and after the proposed acquisition was announced) and a 9% promissory note in the principal amount of \$3.5 million, to be repaid in installments of \$0.1 million of principal and interest quarterly commencing on March 15, 2002, for a total of eleven (11) payments. All remaining principal and interest shall become due on December 15, 2004. The Company incurred approximately \$1.0 million of acquisition related costs. The purchase price was allocated to the tangible and intangible assets acquired (patent and core technology, trade names and trademarks, and workforce) and liabilities assumed based on their respective F-22 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) fair market values. The total identifiable tangible and intangible assets amounted to \$21.2 million. The excess purchase price of \$23.0 million has been allocated to identifiable long-lived assets based on their respective percentages of fair value. The purchase price including acquisition costs was allocated as follows (in thousands): Identified intangible assets..... \$20,970 Net current liabilities assumed..... (1,976) Fixed assets..... 275 ----- \$19,269 ===== The values of the patents, core technology and trade names and trademarks were determined using the income approach. The income approach requires a projection of revenues and expenses specifically attributed to the intangible assets. The discounted cash flow ("DCF") method is then applied to the potential income streams after making necessary adjustments with respect to such factors as the wasting nature of the identifiable intangible assets and the allowance of a fair return on the net tangible assets and other intangible assets employed. There are several variations on the income approach, including the relief- from-royalty method, the avoided cost method and the lost profits method. The relief-from-royalty method was used to value the patents, core technology and trade names and trademarks. The relief-from-royalty method is used to estimate the cost savings that accrue to the owner of the intangible assets that would otherwise have to pay royalties or licensee fees on revenues earned through the use of the asset. The royalty rate used in the analysis is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The market-derived royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the patents and core technology are as follows: royalty rate 5%, discount rate 15%, tax rate 40% and estimated life of 10 years. The key assumptions used in valuing the trade names and trademarks are as follows: observed royalty rate 1%, discount rate 15%, tax rate 40% and estimated life of 12 years. OEM contracts and customer relationships, as well as completed technology, were determined to have de minimus values and, accordingly, no amount of the purchase price was allocated to these intangible assets. A discounted cash flow method was used to estimate the residual cash flows attributable to OEM contracts and customer relationships. The projections included negative cash flows over the early years of the relationship and, when combined with the contributory asset charged for the other technology-based assets, such as patents and core technology which are required to realize revenue under these arrangements, resulted in de minimus value for the OEM contracts and the customer relationships. The completed technology was valued using individual cash flow projections for each technology, adjusted for capital charges, and discounted to present value using a weighted average cost of capital. Cash flow projections and operating profits are negative for the initial years and when considered with the short life cycle of the application-based completed technology, the value ascribable to the completed technology was de minimus. F-23 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) The following table identifies the intangible assets acquired in connection with L&H and their respective lives: AMOUNT LIFE (IN THOUSANDS) (IN YEARS) ----- Patents and core technology..... \$17,870 10 Trade names and trademarks..... 3,100 12 ----- \$20,970 ===== In connection with the acquisition, we assumed certain liabilities for products which were sold prior to the acquisition date and which are expected to be upgraded with newer versions in 2002 and liabilities for development contracts with customers. The actual amount of the liabilities may differ from the estimated amounts. Differences between the actual and estimated amounts will be recorded as an adjustment to the liability. CAERE ACQUISITION On March 13, 2000, the Company acquired all of the outstanding capital stock of Caere Corporation, a California-based

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company that designed, developed and marketed a range of optical character recognition software tools, for approximately \$48.5 million in cash, 19.0 million shares of common stock of the Company valued at \$98.5 million, and the issuance of stock options for the purchase of approximately 4.6 million shares of the Company's common stock valued at \$15.5 million, in exchange for outstanding employee stock options of Caere. The fair value of the employee stock options was estimated using the Black-Scholes option pricing model. In addition, pursuant to a concurrent non-competition agreement and subject to certain other conditions, the Company agreed to pay in cash the former Caere President and CEO on the second anniversary of the merger, March 13, 2002, the difference between \$13.50 and the closing price per share of ScanSoft common stock at that time, multiplied by 486,548. The value of this stock price guarantee at the date of acquisition was approximately \$4.1 million and has been included in the total purchase price of the acquisition (see Note 15). Additionally, in conjunction with the acquisition, the Company incurred approximately \$1.8 million of acquisition related costs. The purchase price of Caere, including acquisition costs was allocated as follows (in thousands):

Property and equipment.....	\$ 2,865	Current and other tangible assets.....	58,400
Liabilities assumed.....	(16,985)	Goodwill.....	61,095
Core technology.....	17,905	Developed technology.....	16,340
Other identified intangible assets.....	10,448	Acquired in-process research and development.....	18,291

----- \$168,359 ===== The amounts allocated to identifiable tangible and intangible assets, including acquired in-process research and development, were based on the fair value of the assets. Goodwill represents the amount by which the cost of acquired net assets exceeded the fair values of those net assets on the date of purchase. Acquired in-process research and development represented development projects that had not yet reached technological feasibility and had no alternative future use. Accordingly, the amount of \$18.3 million was charged to operations upon consummation of the acquisition.

SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The values of the core technology, developed technology and acquired in-process technology were determined by a risk adjusted, discounted cash flow approach. The value of in-process research and development was determined by estimating the costs to develop the in-process projects into commercially viable products, estimating the resulting net cash flows from the sale of such products, discounting net cash flows back to their present values, and adjusting those results to reflect the projects' stages of completion at the acquisition date. These include projects (primarily major version upgrades) in each of Caere's major products, including OmniPage, OmniForm, and PageKeeper. The discount rates used were 14% for developed technology, 19% for core technology, and 24% for in-process technology. The discount rate for in-process technology takes into consideration the Company's weighted average cost of capital adjusted for the inherent uncertainties surrounding the successful development of the in-process research and development, the profitability levels of such technology and the uncertainty of technological advances, which could potentially impact the estimates described above. The percentage of completion of the in-process projects ranged from 50% to 67% at the date of the acquisition. Revenues were initially projected to be generated in late 2000 for each of the product versions in development at the acquisition date. As of December 31, 2000, revenues from these projects were expected to be generated beginning in the second quarter of 2001. All these projects were completed during 2001. The table following identifies the intangible assets acquired in connection with Caere and their respective lives:

AMOUNT LIFE (IN THOUSANDS) (IN YEARS) -----	Goodwill.....	\$ 61,095	6		
Core technology.....	17,905	5	Developed technology.....	16,340	2
Other identified intangible assets.....	10,448	2-5	-----	\$105,788	=====

Other identified intangible assets consist of a non-compete agreement, acquired work force, a favorable building lease agreement, and patents on the Caere technology. These assets have expected useful lives of 2, 3, 4 and 5 years, respectively, and are being amortized accordingly. During the year ended December 31, 2000, the Company, as a result of its June restructuring (see Note 12), wrote-off \$1.1 million of acquired workforce and \$2.4 million of the favorable building lease established as part of the identifiable intangible assets acquired from Caere. The portion of the assets impaired related directly to the number of employees terminated and facility space vacated in connection with these restructuring actions. This acquisition has been accounted for under the purchase method of accounting. Accordingly, the results of operations of Caere and the fair market value of acquired assets and assumed liabilities have been included in the financial statements of the Company as of the date of acquisition.

SCANSOFT ACQUISITION

On March 2, 1999, the Company acquired the business of ScanSoft, Inc., an indirect wholly-owned subsidiary of Xerox Corporation, for approximately 6.8 million shares of common stock valued at \$10.4 million, 3.6 million shares of non-voting preferred stock valued at \$4.6 million and the issuance of stock options for the purchase of approximately 1.7 million shares of the Company's common stock, valued F-25 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) at \$2.4 million, in exchange for outstanding employee stock options of ScanSoft. In conjunction with the acquisition, the Company incurred approximately \$1.2 million of acquisition related costs. The purchase price of \$18.6 million was allocated to the tangible and intangible assets (acquired in-process research and development, core technology, trade mark and trade name, and assembled workforce) acquired and liabilities assumed based on fair value. Acquired in-process research and development represented development projects that had not yet reached technological feasibility and had no alternative future use. Accordingly, the amount of \$3.9 million was charged to operations upon consummation of the acquisition. The purchase price was allocated as follows (in thousands):

Property and equipment.....	\$ 909	Current and other assets.....	4,813
Liabilities assumed.....	(2,166)	Identified intangible assets.....	11,096
Acquired in-process research and development.....	3,944	-----	\$18,596

===== This acquisition has been accounted for under the purchase method of accounting. Accordingly, the results of operations of ScanSoft and the fair value of acquired assets and assumed liabilities have been included in the financial statements of the Company as of the date of acquisition. The values of the core technology and acquired in-process technology were determined by a risk adjusted, discounted cash flow approach. The value of in-process research and development, specifically, was determined by estimating the costs to develop the in-process projects into commercially viable products, estimating the resulting net cash flows from the sale of such products, discounting net cash flows back to their present values, and adjusting those results to reflect the projects' stages of completion at the acquisition date. These projects include projects (primarily major version releases) in each of ScanSoft's major products, including ScanWorks, Pagis, TextBridge and API. The discount rate used for the core technology and in-process technology was 20% and 25%, respectively. This discount rate takes into consideration the Company's weighted-average cost of capital adjusted for the inherent uncertainties surrounding the successful development of the in-process research and development, the profitability levels of such technology and the uncertainty of technological advances, which could potentially impact the estimates described above. The percentage of completion of the

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projects ranged from 73% to 95% at the date of acquisition. All of the projects were successfully completed in 1999. The following table identifies the intangible assets acquired in connection with ScanSoft and their respective lives: AMOUNT LIFE (IN THOUSANDS) (IN YEARS) ----- Core technology..... \$ 8,747 6 Trademark..... 1,800 7 Workforce..... 549 3 ----- \$11,096 =====

ACQUISITION OF METACREATIONS PRODUCT LINES On June 30, 1999, the Company entered into a definitive asset purchase agreement (the "Purchase Agreement") and license agreement (the "License") to acquire and license certain assets and intellectual property relating to the photo imaging software products business of MetaCreations Corporation F-26 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) ("MetaCreations"), which include Kai's PhotoSoap 1.0 and 2.0, Kai's SuperGOO 1.0, Kai's PowerGOO 1.0 and Kai's Power SHOW 1.1 (the "Products"). Pursuant to the Purchase Agreement, the Company purchased all MetaCreations' inventory, intangibles, marketing materials and website content relating to the Products. Under the License Agreement, MetaCreations granted the Company a perpetual non-exclusive, royalty free license to use, reproduce, license, sell and distribute the intellectual property relating to the Products and other related software technology. The Company paid MetaCreations an aggregate of \$1.0 million in cash and issued a 7% promissory note in the principal amount of \$1.6 million, due and paid in full on June 30, 2000. Additionally, the Company assumed the obligations to fulfill sales orders relating to the Products, all liabilities under all original equipment manufacturer and other agreements pertaining to the Products, and up to \$950,000 of product returns relating to Products sold prior to the date of the Purchase Agreement. The purchase price was allocated to the tangible and intangible assets (core technology, OEM relationships, trademarks, and registered users base) acquired and liabilities assumed based on fair value. The allocation of purchase price is estimated as follows (in thousands): Net liabilities assumed..... \$(1,234) Identified intangible assets..... 3,834 ----- \$ 2,600 =====

The following table identifies the intangible assets acquired in connection with MetaCreations and their respective lives: AMOUNT LIFE (IN THOUSANDS) (IN YEARS) Core technology..... \$1,934 3 OEM relationships..... 1,100 3 Trademark and registered users..... 800 3 ----- \$3,834 =====

During the fourth quarter of 2000, based on the financial results of the MetaCreations products, the Company reviewed the estimated future lives of the MetaCreations intangible assets. As a result of this review, the Company reduced the future amortization period of these intangible assets with lives greater than three years at December 31, 2000, to three years, resulting in increased amortization of \$248,000 per year over the remaining lives. PRO FORMA RESULTS (UNAUDITED) The following table reflects unaudited pro forma results of operations of the Company assuming that the acquisition of ScanSoft and Caere had occurred on January 1, 1999 (in thousands, except per share data): YEAR ENDED DECEMBER 31, ----- 2001 2000 1999 ----- Revenues..... \$ 94,699 \$ 58,956 \$ 93,299 Net loss..... \$(53,803) \$(45,098) \$(21,248) Net loss per diluted share..... \$ (0.95) \$ (1.05) \$ (0.46) These unaudited pro forma results of operations do not include the hardware business or the write-off of acquired in-process research and development as these amounts were non-recurring in nature. The F-27 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) unaudited pro forma results of operations are not necessarily indicative of the actual results that would have occurred had the transactions actually taken place at the beginning of these periods. ADOPTION OF SFAS 142 Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets or SFAS 142. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. The standard also includes provisions for the reassessment of the useful lives of existing recognized intangible assets and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS 142 required the Company to complete a transitional goodwill impairment test within six months of the date of adoption. The Company reassessed the useful lives of its existing intangible assets, other than goodwill, and concluded that the original useful lives remain appropriate. In addition, the Company determined that it operates in one reporting unit and, therefore, has completed the goodwill impairment test on an enterprise-wide level as of January 1, 2002. Based on this analysis, the Company determined that goodwill recorded was not impaired, and no impairment charge has been recorded. The following summary reflects the consolidated results of operations as if the amortization provisions of SFAS 142 had been adopted at the beginning of the periods presented (in thousands, except net loss per share amounts): YEARS ENDED DECEMBER 31, ----- 2001 2000 1999 ----- Net loss: Reported net loss..... \$(16,877) \$(53,251) \$(2,748) Effect of goodwill amortization..... 10,389 9,601 152 ----- Adjusted net loss..... \$ (6,488) \$(43,650) \$(2,596) ===== Basic net loss per share: Reported basic net loss per share..... \$ (0.34) \$ (1.26) \$ (0.11) Effect of goodwill amortization..... 0.21 0.23 0.01 ----- Adjusted basic net loss per share..... \$ (0.13) \$ (1.03) \$ (0.10) ===== Diluted net loss per share: Reported diluted net loss per share..... \$ (0.13) \$ (1.03) \$ (0.10) =====

12. RESTRUCTURING AND OTHER CHARGES In connection with the acquisition of Caere in the first quarter of 2000, ScanSoft identified 46 employees of Caere whose positions were eliminated upon consummation of the acquisition. These positions included 22 in research and development, 14 in general and administrative functions, and 10 in sales and marketing. Additionally, the Caere president and CEO position was eliminated. As a result, ScanSoft established as part of the purchase price allocation, a restructuring reserve of \$0.5 million for severance payments to employees, and a restructuring reserve of \$1.1 million for severance to the Caere former president and CEO, the payments of which will continue through March 2005. In June 2000, ScanSoft implemented a restructuring plan to strategically refocus our business and bring operating expenses in line with net revenues. As a result, the Company eliminated 65 employee positions including 29 in research and development, 13 in general and administrative functions and 23 in support and marketing. ScanSoft recorded a restructuring charge in the amount of \$1.1 million for F-28 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) severance payments to these employees and a restructuring charge of \$0.4 million for certain termination fees to be incurred as a result of exiting the Los Gatos facility. Additionally, ScanSoft wrote-off \$3.5 million of net intangible assets acquired as part of the Caere acquisition including the acquired work force of \$1.1 million and the favorable building lease of \$2.4 million, which were impaired as a result of the restructuring action. For the years ended December 31, 2001 and 2000, ScanSoft paid \$0.8 million and \$1.1 million, respectively in severance payments related to these restructuring actions. The remaining severance balance of \$0.6 million primarily relates to severance for the former Caere President and CEO and will be paid through March 2005. The Company was obligated to pay retention bonuses amounting to approximately \$0.8 million and \$0.2 million relating to key employees who were employed in the Caere integration and restructuring of the companies, respectively. These retention bonuses were expensed as incurred and were not included

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in the purchase price of the acquisition. As of December 31, 2000, the Company had paid all of these bonuses. During the fourth quarter of 2000, the Company incurred an additional \$0.3 million of facility related exit costs related to leasehold improvements on the Los Gatos facility in space vacated by the Company. Additionally, during the fourth quarter the Company reversed \$0.4 million of restructuring accruals taken in June 2000. Facility related contracts accounted for \$0.3 million of the reserve. The remaining \$0.1 million related to severance accruals for employees who left the Company prior to being eligible to receive severance benefits. The following table sets forth the 2001 and 2000 restructuring reserve activity (in thousands): LEASE INTANGIBLE EMPLOYEE EXIT ASSET RESTRUCTURING AND OTHER CHARGES RESERVE RELATED COSTS IMPAIRMENT TOTAL ----- Restructuring

reserve provided in March 2000 acquisition.....	\$ 1,552	\$ 1,552	Restructuring and other charges for June 2000 restructuring.....	1,069	\$ 397	\$ 3,490	4,956	Additional Restructuring charges for June 2000 restructuring.....	276	276
Reversal of excess restructuring charges related to June 2000 restructuring.....	(73)	(347)	(420)	Non-cash write-off.....	(276)					
(3,490)	(3,766)	Cash payments.....	(1,120)	(1,120)	-----	-----	-----	Balance at December 31, 2000.....	1,428	50 --
1,478	Cash payments.....	(794)	(50)	(844)	-----	-----	-----	Balance at December 31, 2001.....	\$ 634	\$ -- \$ -- \$ 634

===== Pursuant to the disposal of the hardware business and acquisition of the software business of ScanSoft, the Company initiated restructuring actions in the first quarter of 1999 and recorded a charge of \$346,000 for such actions. All planned restructuring actions were completed and all related liabilities were paid in 1999. F-29 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 13. RELATED PARTIES At December 31, 2001, Xerox owned approximately 19% of the Company's outstanding common stock and all of the Company's outstanding Series B Preferred Stock. In addition, Xerox has the opportunity to acquire additional shares of common stock pursuant to a warrant (see Note 5). The Company and Xerox have entered into multiple non-exclusive agreements in which the Company grants Xerox the royalty-bearing right to copy and distribute certain versions of the Company's software programs with Xerox's multi-function peripherals. Xerox accounted for 11%, 12% and 15% of total revenues during each of the years ended December 31, 2001, 2000 and 1999, respectively. As of December 31, 2001 and 2000, Xerox owed the Company \$1.8 million and \$1.6 million, respectively, pursuant to these agreements. On September 13, 1999, the Company purchased 600,000 shares of Series A Preferred Stock, par value \$0.10 per share, at a cost of \$0.25 per share for a total investment of \$150,000 in BookmarkCentral.com (which was recently renamed EchoBahn.com, Inc.). One of the Company's former directors, is a founder and the current President and Chief Executive Officer of EchoBahn. During 2001, the Company wrote-off its cost basis investment, in EchoBahn as a result of factors which indicated the investment was impaired. 14. SALE OF HARDWARE BUSINESS On January 6, 1999 the Company sold the assets, liabilities and intellectual property related to the former hardware business to Primax for approximately \$6.8 million in cash. The Company reported a non-operating gain of \$0.9 million related to the sale of the hardware business, net of costs and expenses of disposing of the business. 15. SUBSEQUENT EVENTS On March 5, 2002, the Company negotiated an agreement with the former Caere President and CEO to terminate the non-competition agreement entered into in connection with the Caere acquisition (see Note 11). Under the terms of the termination agreement, the calculation date for payments due as well as the expiration date of options to purchase 829,000 shares of common stock were accelerated to February 12, 2002. The resulting total cash payment will be paid as follows: \$1.0 million immediately with the remainder payable in equal quarterly installments of approximately \$0.4 million over the next two years. The final consideration under the termination agreement will result in a reduction of additional-paid-in capital of approximately \$4.3 million in fiscal 2002 and will have no effect on the results of operations. F-30 SCANSOFT, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 16. QUARTERLY DATA (UNAUDITED) The following information has been derived from unaudited consolidated financial statements that, in the opinion of management, include all recurring adjustments necessary for a fair presentation of such information. FIRST SECOND THIRD FOURTH QUARTER QUARTER QUARTER QUARTER YEAR -----

----- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) 2001 Revenue.....	\$ 12,801	\$ 15,078	\$ 17,066	\$ 18,910	\$ 63,855	Net loss.....	\$ (6,900)	\$ (4,395)	\$ (3,214)	\$ (2,368)	\$ (16,877)	Earnings per share: Basic.....	\$ (0.15)	\$ (0.09)	\$ (0.06)	\$ (0.04)	\$ (0.34)	Diluted.....	\$ (0.15)	\$ (0.09)	\$ (0.06)	\$ (0.04)	\$ (0.34)	Weighted average common shares outstanding: Basic.....	46,100	48,939	50,875	52,858	49,693	Diluted.....	46,100	48,939	50,875	52,858	49,693	2000
Revenue.....	\$ 7,415	\$ 13,975	\$ 13,638	\$ 14,027	\$ 49,055	Net loss.....	\$ (23,938)	\$ (16,028)	\$ (7,076)	\$ (6,209)	\$ (53,251)	Earnings per share: Basic.....	\$ (0.78)	\$ (0.35)	\$ (0.15)	\$ (0.13)	\$ (1.26)	Diluted.....	\$ (0.78)	\$ (0.35)	\$ (0.15)	\$ (0.13)	\$ (1.26)	Weighted average common shares outstanding: Basic.....	30,529	45,918	45,963	46,032	42,107	Diluted.....	30,529	45,918	45,963	46,032	42,107	

F-31 REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULE To the Board of Directors and Stockholders of ScanSoft, Inc: Our audits of the consolidated financial statements referred to in our report dated February 11, 2002, except as to Note 15 for which the date is March 5, 2002, appearing in this Registration Statement on Form S-1 of ScanSoft, Inc. also included an audit of the financial statement schedule listed in the index on page F-1 of such Registration Statement. In our opinion, the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. /s/ PricewaterhouseCoopers LLP Boston, Massachusetts February 11, 2002 F-32 SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS AND RESERVES ACCOUNTS RECEIVABLE 2001 2000 1999 ----- (IN THOUSANDS) Balance at beginning of period.....	\$ 7,375	\$ 3,690	\$ 4,171	Additions charged to costs and expenses.....	186	726	9,305	Additions charged to other accounts.....	(1,185)	(a) 3,116	(a) 987	Deductions and write-offs.....	(103)	(157)	(10,773)	-----	-----	-----	Balance at end of period.....	\$ 6,273	\$ 7,375	\$ 3,690	=====	=====	=====
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----- (a) Amounts recorded against revenue representing estimates of potential future product returns and price protection and rebate offers as of December 31, 2001 and 2000, respectively. F-33 SCANSOFT, INC. UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2002 AND DECEMBER 31, 2001 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001 F-34 SCANSOFT, INC. CONSOLIDATED BALANCE SHEETS SEPTEMBER 30, DECEMBER 31, 2002 2001 -----

----- (UNAUDITED) (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA) ASSETS Current Assets: Cash and cash equivalents.....	\$ 14,382	\$ 14,324	Accounts receivable, less allowances of \$7,650 and \$6,273, respectively.....	15,868	12,464	Receivables from related party.....	1,238	1,802	Inventory.....	1,562	507	Prepaid expenses and other current assets.....	2,853	1,614	-----	-----	-----	Total
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current assets..... 35,903 30,711 Goodwill..... 63,308 65,231 Other intangible assets,
net..... 36,035 43,301 Property and equipment, net..... 2,933 2,150 Other assets.....
1,091 677 ----- TOTAL ASSETS..... \$ 139,270 \$ 142,070 ===== LIABILITIES AND
STOCKHOLDERS' EQUITY Current Liabilities: Accounts payable..... 5,541 5,320 Accrued
expenses..... 11,695 14,471 Deferred revenue..... 955 1,375 Note
payable..... 227 227 Other current liabilities..... 1,720 ----- Total current
liabilities..... 20,138 21,393 Deferred revenue..... 278 2,534 Long-term note payable, net of current
portion..... 3,101 3,273 Other liabilities..... 819 336 ----- Total liabilities..... 24,336
27,536 ----- Commitments and contingencies (Note 10, 11 and 12) Stockholders' equity: Preferred stock, \$0.001 par value;
40,000,000 shares authorized; 3,562,238 shares issued and outstanding (liquidation preference \$4,631)..... 4,631 4,631 Common
stock, \$0.001 par value; 140,000,000 shares authorized; 65,334,366 and 62,754,211 shares issued and 63,216,988 and 62,098,211 shares
outstanding, respectively..... 65 63 Additional paid-in capital..... 269,822 264,893 Treasury stock, at
cost; 2,117,378 and 656,000 shares, respectively..... (8,031) (1,031) Deferred compensation..... (199)
(276) Accumulated other comprehensive income (loss)..... 12 (487) Accumulated deficit..... (151,366) (153,259)
----- Total stockholders' equity..... 114,934 114,534 ----- TOTAL LIABILITIES AND STOCKHOLDERS'
EQUITY..... \$ 139,270 \$ 142,070 ===== The accompanying notes are an integral part of these consolidated financial
statements. F-35 SCANSOFT, INC. CONSOLIDATED STATEMENTS OF OPERATIONS NINE MONTHS ENDED SEPTEMBER 30,
----- 2002 2001 ----- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (UNAUDITED) Revenue, third
parties..... \$74,598 \$ 38,773 Revenue, related party..... 3,586 5,357 ----- Total
revenue..... 78,184 44,130 ----- Costs and expenses: Cost of revenue..... 12,937 9,215
Cost of revenue from amortization of intangible assets.... 7,494 10,536 Research and development..... 21,310 10,016 Selling,
general and administrative..... 32,051 18,944 Amortization of goodwill and other intangible assets..... 1,446 9,964 Restructuring and
other charges..... 1,041 ----- Total costs and expenses..... 76,279 58,675 ----- Income (loss)
from operations..... 1,905 (14,545) Other income (expense), net..... (178) (126) ----- Income (loss)
before income taxes..... 1,727 (14,671) Provision for (benefit from) income taxes..... (166) (162) ----- Net income
(loss)..... \$ 1,893 \$(14,509) ===== Net income (loss) per share: basic..... \$ 0.03 \$ (0.30)
===== Net income (loss) per share: diluted..... \$ 0.03 \$ (0.30) ===== Weighted average common
shares: basic..... 67,116 48,638 ===== Weighted average common shares: diluted..... 72,451 48,638
===== The accompanying notes are an integral part of these consolidated financial statements. F-36 SCANSOFT, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS NINE MONTHS ENDED SEPTEMBER 30, ----- 2002 2001 -----
(IN THOUSANDS) (UNAUDITED) CASH FLOWS FROM OPERATING ACTIVITIES: Net income (loss)..... \$ 1,893
\$(14,509) Adjustments to reconcile net loss to net cash provided by operating activities: Depreciation and amortization..... 1,535
1,395 Allowances for returns and bad debts..... 1,246 (1,460) Amortization of intangible assets..... 8,940 20,500 Non-cash
portion of restructuring and other charges.... 113 -- Gain on disposal or sale of property and equipment.... (30) (89) Deferred
compensation..... 77 -- Changes in operating assets and liabilities, net of effects of acquisitions: Accounts
receivable..... (4,234) (147) Inventory..... (1,003) 335 Prepaid expenses and other assets.....
(1,189) 613 Other assets..... (273) -- Accounts payable..... (292) (799) Accrued
expenses..... 2,162 (1,117) Deferred revenue..... (2,682) 1,371 ----- Net cash provided by
operating activities..... 6,263 6,093 ----- CASH FLOWS FROM INVESTING ACTIVITIES: Capital expenditures for property
and equipment..... (2,090) (563) Proceeds from sale of property and equipment..... 42 344 Payments of acquisition-related
liabilities..... (2,360) -- Cash paid for acquisition..... (500) -- Other..... -- 62 -----
Net cash used in investing activities..... (4,908) (157) ----- CASH FLOWS FROM FINANCING ACTIVITIES: Payments on
short-term borrowings..... -- (3,400) Payments of capital lease obligation..... (238) -- Purchase of treasury
stock..... (7,000) (521) Payments of notes payable related to acquisition..... (586) -- Payments under deferred payment
agreement..... (1,824) -- Proceeds from private placement of common stock, net of issuance costs..... 5,690 4,995
Proceeds from the issuance of common stock upon exercise of options..... 2,545 -- ----- Net cash provided by
(used in) financing activities..... (1,413) 1,074 ----- Effects of exchange rate changes on cash and cash
equivalents..... 116 (312) ----- Net increase in cash and cash equivalents..... 58 6,698 Cash and cash
equivalents at beginning of period..... 14,324 2,571 ===== Cash and cash equivalents at end of period..... \$14,382 \$
9,269 ===== Supplemental disclosure of noncash investing activities: Shares issued in connection with the purchase of assets
(Note 5)..... \$ 600 \$ -- ===== The accompanying notes are an integral part of these consolidated
financial statements. F-37 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED 1.
BASIS OF PRESENTATION The accompanying unaudited consolidated financial statements of ScanSoft, Inc. (the "Company", "we" or
"ScanSoft") have been prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of
management, these interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a
fair presentation of the financial position at September 30, 2002 and 2001 and the results of operations and cash flows for the nine months ended
September 30, 2002 and 2001. Although the Company believes that the disclosures in these financial statements are adequate to make the
information presented not misleading, certain information normally included in the footnotes prepared in accordance with generally accepted
accounting principles has been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The
accompanying financial statements should be read in conjunction with the audited financial statements and notes thereto included in the
Company's Annual Report on Form 10-K for the year ended December 31, 2001 filed with the Securities and Exchange Commission on April 1,
2002. The results for the nine months ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year

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ending December 31, 2002, or any future period. Certain prior year financial statement amounts have been reclassified to conform with the current year presentation. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities on the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant estimates and assumptions included in the financial statements are revenue recognition, including estimating valuation allowances (specifically sales returns and other allowances), the recoverability of intangible assets, including goodwill, and valuation allowances for deferred tax assets. Actual amounts could differ significantly from these estimates. Royalty revenue derived from sales to OEM partners is recognized when software copies are deployed and payment is due. Royalty revenue from OEM customers with whom the Company has significant past experience is recognized based on estimated deployments in the respective period. Differences between estimates and actual deployments are recorded as an adjustment to revenue in the following quarter. These estimates have been based on timely, informal communications with the OEMs and the past payment and royalty reporting history of the OEMs, seasonality of the OEM's business, the number of copies deployed in prior periods and the overall economic climate in which the OEMs operate. For the quarters ended June 30, 2001, March 31, 2002 and June 30, 2002, differences between the actual and estimated deployments resulted in differences between reported and actual revenue of \$(0.5) million, \$(0.3) million and \$0.3 million, respectively, with a corresponding impact on operating and net income/(loss) for such periods. The Company deemed that these differences would not have a material impact on the results of operations for the years ending December 31, 2001 and December 31, 2002, respectively. The Company believes that it can more accurately determine OEM revenue based on reports of actual deployments received from OEM customers. While historically the Company has been unable to obtain OEM deployment reports prior to reporting financial results, the Company now believes it is in a position to obtain such reports on a timely basis. Therefore, beginning with the fourth quarter of 2002, the Company intends to report OEM revenue based on actual deployments as reported by OEM customers. On December 12, 2001, the Company acquired certain assets of Lernout & Hauspie Speech Products N.V. and certain of its affiliates. On December 27, 2001, the Company filed a Form 8-K reporting the F-38 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) transaction as an acquisition of assets. As previously disclosed, the Company had ongoing discussions with the SEC regarding historical financial statement requirements related to the acquisition. Following these discussions, the Company concluded that, for purposes of Rule 3-05 of Regulation S-X, the L&H transaction was an acquisition of a business and not an acquisition of assets. In connection with these discussions, the Company also concluded that the transaction should be reported as the acquisition of a business for accounting purposes rather than the acquisition of assets, as previously reported. On August 14, 2002, the Company filed a Form 10-Q/A to restate the financial statements as of and for the quarter ended March 31, 2002 to reflect the impact of the change in the accounting for the acquisition. As a result of the change in accounting, \$23.0 million of the purchase price previously allocated to tangible and other intangible assets has been reclassified to goodwill and amortization expense has been reduced by \$0.6 million. The restatement had no material effect on the financial position or results of operations as of or for the year ended December 31, 2001. A summary of the impact of this restatement on the consolidated financial statements as of and for the unaudited three-month period ended March 31, 2002 is as follows: THREE MONTHS ENDED MARCH 31, 2002 ----- AS PREVIOUSLY REPORTED AS RESTATED (IN THOUSANDS, EXCEPT PER SHARE DATA) -----

Statement of Operations: Amortization of goodwill and other intangible assets.....	\$ 5,111	\$ 4,499
Loss from operations.....	(3,213)	(2,601)
Net loss.....	\$(3,494)	\$(2,882)
Net loss per share -- basic and diluted.....	\$ (0.06)	\$ (0.05)

MARCH 31, 2002 ----- AS PREVIOUSLY REPORTED AS RESTATED -----

Balance Sheet: Goodwill, net.....	\$ 42,200	\$ 65,231
Other intangible assets, net.....	62,638	40,476
Property and equipment, net.....	2,838	2,582
Accumulated deficit.....	(156,753)	(156,141)

2. RECENT ACCOUNTING PRONOUNCEMENTS In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS 144). The objectives of SFAS 144 are to address significant issues relating to the implementation of FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (SFAS 121), and to develop a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. SFAS 144 supersedes SFAS 121; however, it retains the fundamental provisions of SFAS 121 for (1) the recognition and measurement of the impairment of long-lived assets to be held and used and (2) the measurement of long-lived assets to be disposed of by sale. SFAS 144 supersedes the accounting and reporting provisions of Accounting Principles Board No. 30, "Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" (APB 30), for segments of a business to be disposed of. However, SFAS 144 retains the requirement of APB 30 that entities report discontinued operations F-39 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) separately from continuing operations and extends that reporting requirement to "a component of an entity" that either has been disposed of or is classified as "held for sale." SFAS 144 also amends the guidance of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a temporarily controlled subsidiary. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, including interim periods, and, generally, its provisions are to be applied prospectively. The Company adopted the provisions of SFAS 144 in 2002 and its adoption had no impact on its financial position or results of operations. In November 2001, the Emerging Issues Task Force ("EITF"), a committee of the FASB, reached a consensus on EITF Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" (EITF 01-9). EITF 01-9 presumes that consideration from a vendor to a customer or reseller of the vendor's products is a reduction of the selling prices of the vendor's products and, therefore, should be characterized as a reduction of revenue when recognized in the vendor's income statement and could lead to negative revenue under certain circumstances. Revenue reduction is required unless consideration relates to a separate identifiable benefit and the benefit's fair value can be established, in which case such amounts may be recorded as operating expenses. The Company implemented EITF 01-9 on January 1, 2002. The implementation resulted in a \$0.3 million reduction to net revenue and a corresponding reduction to selling, general and administrative expenses for the nine months ended September 30, 2002. Additionally, it resulted in the reclassification of \$0.8 million from selling, general and administrative expenses to net revenue for the nine months ended September 30, 2001. In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal

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Activities" (SFAS No. 146). This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF 94-3). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. EITF 94-3 allowed for an exit cost liability to be recognized at the date of an entity's commitment to an exit plan. SFAS 146 also requires that liabilities recorded in connection with exit plans be initially measured at fair value. The provisions of SFAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002, with early adoption encouraged. The Company does not expect the adoption of SFAS 146 will have a material impact on its financial position or results of operations. 3.

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

SEPTEMBER 30, 2002 Inventory: Raw materials..... \$ -- Finished goods..... 1,562,400 \$ 1,562,400 Other accrued expenses: Accrued compensation..... \$ 2,483,275 Accrued sales and marketing..... 1,566,160 Accrued restructuring..... 732,634 Accrued royalties..... 491,750	2001 Inventory: Raw materials..... \$ -- Finished goods..... 1,070,000 \$ 1,070,000 Other accrued expenses: Accrued compensation..... \$ 2,775,000 Accrued sales and marketing..... 1,160,000 Accrued restructuring..... 634,000 Accrued royalties..... 750,000
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UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) SEPTEMBER 30, DECEMBER 31, 2002 2001 -----
 ----- Accrued professional fees..... 525,571
 Accrued acquisition liabilities..... 1,800,606
 Accrued income taxes and other..... 4,098,251
 \$ 11,695,147

During the nine months ended September 30, 2002, the Company entered into settlement agreements related to certain contractual liabilities assumed in connection with the acquisition of the majority of the speech and language technology operations of L&H (L&H acquisition), which occurred on December 12, 2001. Upon settlement of these liabilities, \$1.9 million of the assumed liabilities recorded at the date of acquisition were reversed with a corresponding reduction recorded to the carrying value of goodwill. 4. **GOODWILL AND OTHER INTANGIBLE ASSETS** In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 142 (SFAS 142), "Goodwill and Other Intangible Assets." SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets, including how goodwill and other intangible assets should be accounted for after they have been initially recognized. SFAS 142 provides that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment; intangible assets with finite useful lives will continue to be amortized over their useful lives. The Company adopted SFAS 142 on January 1, 2002 and discontinued the amortization of goodwill (including acquired workforce) of approximately \$65.2 million. Upon adoption, the Company reclassified \$31,000 of previously amortizable acquired workforce to goodwill. The Company had previously been recording amortization expense on goodwill and acquired workforce of \$10.4 million annually or \$2.6 million per quarter. Under SFAS 142, the Company was required to complete a transitional impairment test on all goodwill effective as of January 1, 2002 on a reporting unit basis. A reporting unit is defined as an operating segment or one level below an operating segment referred to as a component. A component of an operating segment is a reporting unit if the component constitutes a business and discrete financial information is prepared and regularly reviewed by management. The Company determined that it operates in one reporting unit and, therefore, has completed the transitional goodwill impairment test on an enterprise-wide basis. SFAS 142 provides for a two-step impairment test to identify potential goodwill impairment. The first step of the goodwill impairment test compares the fair value of a reporting unit with its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is considered not impaired, thus the second step of the impairment test, which determines the amount of goodwill impairment, is unnecessary. The fair value of the reporting unit was determined using the Company's market capitalization as of January 1, 2002. As the fair value of the reporting unit as of January 1, 2002 was in excess of the carrying amount of the net assets, the Company concluded that its goodwill was not impaired, and no impairment charge was recorded. The Company will complete additional goodwill impairment analyses at least annually or more frequently when events and circumstances occur indicating that the recorded goodwill might be impaired. The Company will perform its annual assessment during the fourth quarter of 2002.

F-41 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Intangible assets are amortized on a straight-line basis over their estimated useful lives of three to twelve years. As required, upon adoption of SFAS 142, the Company reassessed the useful lives of its intangible assets and has determined that no adjustments were required. The following summary reflects the consolidated results of operations as if SFAS 142 had been adopted at the beginning of the periods presented (in thousands, except net income (loss) per share amounts):

NINE MONTHS ENDED SEPTEMBER 30, 2002 Net income (loss): Reported net income (loss)..... \$ 1,893 \$(14,509) Effect of goodwill amortization..... -- 7,790 Adjusted net income (loss)..... \$ 1,893 \$(6,719)	2001 Net income (loss): Reported net income (loss)..... \$ 1,893 \$(14,509) Effect of goodwill amortization..... -- 7,790 Adjusted net income (loss)..... \$ 1,893 \$(6,719)
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=====
 Basic net income (loss) per share: Reported basic net income (loss) per share..... \$ 0.03
 \$(0.30)
 Effect of goodwill amortization..... -- .16
 Adjusted basic net income (loss) per share..... \$ 0.03
 \$(0.14)
 Diluted net income (loss) per share: Reported diluted net income (loss) per share..... \$ 0.03
 \$(0.30)
 Effect of goodwill amortization..... -- .16
 Adjusted diluted net income (loss) per share..... \$ 0.03
 \$(0.14)

=====
 Other intangible assets consist of the following (in thousands):

GROSS CARRYING AMOUNT AMORTIZATION AMOUNT SEPTEMBER 30, 2002 Patents and core technology..... \$ 48,130 \$ 17,343 Completed technology..... 16,340 16,340 Trademarks..... 7,461 2,573 4,888 Non-competition agreement..... 4,048 4,048 Acquired favorable lease..... 553 553 OEM relationships..... 1,100 740 360 Other..... 200 200	DECEMBER 31, 2001 Patents and core technology..... \$ 46,456 \$ 11,771 Completed technology..... 14,714 14,714 Trademarks..... 1,784 1,784 5,677 Non-competition agreement..... 3,646 3,646 Acquired favorable lease..... 355 355 198 OEM relationships..... 524 524 576 Assembled workforce..... 374 270 104 Other..... 200 167 33
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 The balances of patents and core technology, trademarks and assembled workforce at December 31, 2001 reflect the impact of the restatement described in Note 1. As a result of the restatement \$16.6 million and \$2.9 million and \$3.3 million of patents and

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core technology, trademarks and assembled workforce, respectively, were reallocated to goodwill. Aggregate amortization expense was \$8.9 million (\$7.5 included in cost of revenue) for the nine months ended September 30, 2002. Estimated amortization expense for each of the five succeeding fiscal years as of September 30, 2002 is as follows (in thousands):

YEAR ENDING AMOUNT	Remainder of
2002..... \$ 2,212	2003..... 8,847
2005..... 3,576	2006..... 2,327
Thereafter..... 8,812	Total..... \$36,035

5. ACQUISITION On February 22, 2002, the Company entered into a definitive asset purchase agreement (the "Purchase Agreement") to acquire certain assets and intellectual property from L&H Holdings USA, Inc. The transaction was completed on March 21, 2002. Pursuant to the Purchase Agreement, the Company acquired patents and core technology associated with the Audiomining assets of the speech and language technology assets of L&H and paid \$1.5 million in total consideration to L&H as follows: \$0.5 million in cash, 121,359 shares of the Company's common stock valued at \$0.6 million (based on the average of the closing share price of the Company's stock 5 days before and after the date the transaction was completed) and a 9% promissory note in the principal amount of \$0.4 million (the "Note"), with principal and interest to be repaid in full on July 31, 2002. The Company incurred \$0.2 million of acquisition related costs. The purchase price including acquisition costs of \$1.7 million was allocated to core technology. On July 31, 2002, the Company repaid all amounts due under the Note, which included principal and interest of \$414,000.

6. RESTRUCTURING AND OTHER CHARGES In January 2002, the Company announced, and in March 2002 completed, a restructuring plan to consolidate facilities, worldwide sales organizations, research and development teams and other personnel following the December 12, 2001 L&H acquisition. As a result, the Company exited facilities in both F-43 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) North America and Europe, eliminating 21 employee positions, including 12 in research and development and 9 in selling, general and administrative functions. In the first quarter of 2002, the Company recorded a restructuring charge in the amount of \$0.6 million for severance payments to these employees, and a restructuring charge of \$0.4 million for certain termination fees to be incurred as a result of exiting the facilities, including the write-off of previously recorded assembled workforce of \$0.1 million. During the nine months ended September 30, 2002, the Company paid a total of \$0.7 million in severance payments, of which \$0.6 million related to the March 2002 restructuring and \$0.1 million related to severance paid to the former Caere President and CEO, pursuant to a 2000 restructuring. At September 30, 2002, the remaining restructuring accrual from the current and prior restructuring activities amounted to \$0.7 million. This balance is comprised of \$0.2 million of lease exit costs resulting from the 2002 restructuring and \$0.5 million of severance to the former Caere President and CEO. The severance due to the former Caere President and CEO will be paid through March 2005. The following table sets forth activity under the 2002 and 2000 restructuring actions (in thousands):

RESTRUCTURING AND OTHER CHARGES RESERVE EMPLOYEE LEASE RELATED EXIT COSTS TOTAL	Balance at December 31, 2001.....
\$ 634	\$ 634
-- \$ 634 Restructuring and other charges for March 2002 restructuring.....	576 465 1,041
Non cash write-offs..... -- (113) (113) Cash payments.....	(722) (108) (830)
Balance at September 30, 2002.....	\$ 488 \$ 244 \$ 732

7. DEFERRED PAYMENT AGREEMENT In connection with the Caere acquisition in the first quarter of 2000 and pursuant to a concurrent non-competition and consulting agreement, the Company agreed to pay in cash to the former Caere President and CEO, a current member of the Board of Directors of the Company, on the second anniversary of the merger, March 13, 2002, the difference between \$13.50 and the closing price per share of ScanSoft common stock at that time, multiplied by 486,548. On March 5, 2002, the Company negotiated a deferred payment agreement with the former Caere President and CEO to terminate this agreement. Under the terms of the deferred payment agreement, the Company paid \$1.0 million in cash on March 5, 2002 and agreed to make future cash payments totaling \$3.3 million, with such amounts payable in equal quarterly installments of approximately \$0.4 million over the following two years. During the nine months ended September 30, 2002, the Company paid two quarterly installments under this agreement totaling \$0.8 million. The total consideration of this agreement was accounted for in the original Caere purchase price and had no effect on the results of operations. The remaining liability at September 30, 2002 is \$2.4 million, of which \$1.6 million is included in other current liabilities and \$0.8 million is included in other long-term liabilities.

8. NET INCOME (LOSS) PER SHARE Basic net income (loss) per share is computed using the weighted average number of common shares outstanding during the period. Basic net income per share for the nine months ended September 30, 2002 includes the assumed conversion of the Series B Preferred Stock, which participates in dividends with F-44 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) common stock when and if declared as well as the weighted average impact of vested restricted stock shares. Diluted net income (loss) per share is computed based on (i) the weighted average number of common shares outstanding, (ii) the assumed conversion of the Series B Preferred Stock, and (iii) the effect, when dilutive, of outstanding stock options, warrants, and unvested shares of restricted stock using the treasury stock method. The following is a reconciliation of the shares used in the computation of basic and diluted net income (loss) per share (in thousands):

NINE MONTHS ENDED SEPTEMBER 30,	2002	2001
Basic net income (loss) per share: Weighted average number of common shares outstanding.....	63,554	48,638
Assumed conversion of Series B Preferred Stock.....	3,562	--
Weighted average common shares: basic.....	67,116	48,638
Effect of dilutive common equivalent shares: Stock options.....	4,772	--
Warrants.....	468	--
Unvested restricted stock.....	95	--
Weighted average common shares: diluted.....	72,451	48,638

For the nine months ended September 30, 2002, stock options to purchase 1,655,604 shares, of common stock were outstanding but were excluded from the calculation of diluted net income per share because the options' exercise prices were greater than the average market price of the Company's common stock during the period. Potential common shares, including stock options, unvested restricted stock, preferred shares and warrants at September 30, 2001 were approximately 16,544,500. These potential common shares were excluded from the calculation of diluted net loss per share as their inclusion would have been antidilutive for the period presented.

9. COMPREHENSIVE INCOME (LOSS) Total comprehensive income (loss), net of taxes, was \$2.4 million for the nine months ended September 30, 2002, and was (\$14.8) million for the nine months ended September 30, 2001. Total comprehensive income (losses) consisted of net income or losses and foreign currency translation adjustments for the respective periods.

10. COMMITMENTS AND CONTINGENCIES In December 2001, the Company was sued for patent infringement initiated by the Massachusetts Institute of Technology and Electronics For Imaging, Inc. The Company was one of more than 200 defendants named in this suit. Damages are sought in an unspecified

amount. The Company filed an Answer and Counterclaim on July 1, 2002. The Company cannot predict the outcome of the claim, nor can it make any estimate of the amount of damages, if any, for which it will be held responsible in the event of a negative conclusion of the claim. The Company believes this claim has no merit, and it intends to defend the action vigorously.

F-45 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) As a normal incidence of the nature of the Company's business, various claims, charges and litigation have been asserted or commenced against the Company arising from or related to employee relations and other business matters. Management does not believe these claims will have a material effect on the financial position or results of operations of the Company.

11. EQUITY TRANSACTIONS On April 12, 2002, the Company completed a private placement of 1.0 million shares of common stock at a purchase price of \$6.00 per share with SF Capital Partners Ltd., resulting in proceeds, net of issuance costs, of \$5.7 million. In September of 2002, the Company repurchased 1,461,378 shares of common stock from L&H Holdings USA, Inc. and Lernout & Hauspie Speech Products N.V. (collectively, L&H) and certain other parties at \$4.79 per share for a total consideration of \$7.0 million. The price per share was based on the greater of \$4.79 or the twenty day trading average beginning August 14, 2002, which was \$4.67. These shares represented a portion of the common shares that were issued to L&H in connection with the December 12, 2001 acquisition of certain of L&H's speech and language technology operations and the March 21, 2002 acquisition of the AudioMining assets of L&H Holdings USA, Inc. The Company agreed to issue an additional 150,000 shares of its common stock to L&H if it does not complete an underwritten public offering of the shares held by L&H by December 15, 2002. The Company further agreed to issue an additional 150,000 shares of its common stock to L&H if it does not complete an underwritten public offering by February 15, 2003. The Company also will be required to issue an additional 100,000 shares of its common stock to L&H if, by February 15, 2003, it fails to file a registration statement to register the shares remaining unsold. The value ascribed to the potential right to acquire additional shares of the Company's common stock was valued at \$0.3 million using a probability-weighted, Black-Scholes valuation model and recorded as a credit to additional paid-in capital, with a corresponding reduction in additional paid-in capital because the Company has an accumulated deficit. Accordingly, the right had no net effect on the Company's financial position or results of operations. In connection with the agreements described above, entered into in September 2002, the terms of the \$3.5 million promissory note issued as partial consideration for the L&H acquisition were amended to include a debt covenant. The covenant provides for the acceleration of the maturity date of the outstanding principal and interest to January 1, 2003 if consummation of the underwritten public offering does not occur by January 1, 2003. The Company did not complete the offering by January 1, 2003 and accordingly, the debt became immediately due and payable. To fulfill this obligation, on January 3, 2003, the Company paid \$3.3 million in full settlement of all of the outstanding principal and accrued interest under this note. ScanSoft will classify the debt as current in its balance sheet at December 31, 2002.

12. SUBSEQUENT EVENTS On October 7, 2002, the Company signed a definitive agreement with Royal Philips Electronics (Philips) to acquire its Speech Processing Telephony and Voice Control business units and related intellectual property. Under the agreement, the Company will pay Philips \$3.0 million in cash, issue a \$4.9 million note due December 31, 2003 bearing 5.0% interest per annum and issue a \$27.5 million three-year, zero-interest debenture, convertible at any time into shares of the Company's common stock at \$6.00 per share. The Company expects to close the transaction in the first quarter of 2003. On October 21, 2002, the Company filed with the Securities and Exchange Commission two registration statements. The first registration statement was filed in connection with a proposed underwritten public offering of 7.0 million shares of the Company's common stock, of which 6.0 million shares are being offered by Lernout & Hauspie Speech Products N.V. and L&H Holdings USA, Inc. and 1.0 million shares are being offered by the Company. The second registration statement provides for the F-46 SCANSOFT, INC. NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) registration of 9.0 million shares of the Company's common stock on behalf of three large institutional investors. These shares will not be included in the proposed underwritten public offering and are being registered pursuant to registration rights agreements previously entered into by the Company. On October 31, 2002, the Company entered into a two year Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank (the "Bank") that consisted of a \$10,000,000 revolving loan (the "Credit Facility"). Borrowings under the Credit Facility will bear interest at the Bank's prime rate plus 0.375% or 0.75%, which is determined by the Company's fixed charge coverage ratio, as defined in the Loan Agreement. The maximum aggregate amount of borrowings outstanding at any one time will be limited to the lesser of \$10,000,000 or a borrowing base. The borrowing base will be equal to either 80% or 70% of eligible accounts receivable, as defined in the Loan Agreement, which is determined by the Company's fixed charge coverage ratio. Pursuant to the Loan Agreement, the Company will be required to maintain certain financial and non-financial covenants, the most restrictive of which is a quarterly minimum fixed charge coverage ratio of 1.25 to 1.00. Borrowings under the Loan Agreement are collateralized by substantially all of the Company's personal property, predominantly its accounts receivable, but not its intellectual property.

F-47 COMBINED FINANCIAL STATEMENTS OF THE PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL DIVISION OF ROYAL PHILIPS ELECTRONICS N.V. F-48 INDEPENDENT AUDITORS' REPORT The Supervisory Board of Royal Philips Electronics N.V. We have audited the accompanying combined balance sheets of Philips Speech Processing Telephony and Voice Control (A division of Royal Philips Electronics N.V.) as of December 31, 2001 and September 29, 2002, and the related combined statements of operations and comprehensive loss, changes in the net investment of the Philips Group, and cash flows for the year ended December 31, 2001 and the nine-month period ended September 29, 2002. These combined financial statements are the responsibility of Philips Speech Processing Telephony and Voice Control's management. Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Philips Speech Processing Telephony and Voice Control (A division of Royal Philips Electronics N.V.) as of December 31, 2001 and September 29, 2002, and the results of its operations and its cash flows for the year ended December 31, 2001 and the nine-month period ended September 29, 2002, in conformity with generally accepted accounting principles in the United States of America. /s/ KPMG ACCOUNTANTS N.V. Eindhoven, The Netherlands November 15, 2002

F-49 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS

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ELECTRONICS N.V.) COMBINED BALANCE SHEETS DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S ASSETS CURRENTS ASSETS: Cash..... 23 12 Accounts receivable, net (Notes 3 and 16)..... 3,036 4,580 Receivables from related parties (Note 13)..... 512 724 Inventory, net (Note 4)..... 662 773 Deferred income taxes (Notes 9 and 13)..... 25 0 Other current assets (Note 5)..... 240 618 TOTAL CURRENT ASSETS..... 4,498 6,707 ----- Property, plant and equipment, net (Notes 6 and 15)..... 521 388 Intangible assets, net (Note 7)..... 184 135 ----- TOTAL ASSETS..... 5,203 7,230 ===== LIABILITIES AND NET INVESTMENT OF THE PHILIPS GROUP CURRENT LIABILITIES: Accounts payable..... 850 672 Deferred income..... 1,481 1,141 Payables to related parties (Note 13)..... 1,541 2,023 Deferred income tax liability (Notes 9 and 13)..... 17 17 Other accrued liabilities (Note 8)..... 2,153 2,349 TOTAL CURRENT LIABILITIES..... 6,042 6,202 ----- Long-term provisions (Note 10)..... 269 338 TOTAL LIABILITIES..... 6,311 6,540 ----- Commitments and contingencies (Note 14)..... NET INVESTMENT OF THE PHILIPS GROUP..... (1,108) 690 TOTAL LIABILITIES AND NET INVESTMENT OF THE PHILIPS GROUP... 5,203 7,230 ===== The accompanying notes are an integral part of these combined financial statements. F-50 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) COMBINED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS YEAR ENDED NINE MONTHS ENDED DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Revenue, third parties..... 15,801 12,548 Revenue, related parties..... 2,890 389 ----- Total revenue..... 18,691 12,937 ----- Cost of sales..... 3,288 1,731 GROSS PROFIT..... 15,403 11,206 ----- Operating expenses: Selling and marketing..... 15,066 8,581 Research and development (Note 13)..... 13,512 7,874 General and administrative (Note 13)..... 3,877 2,935 Total operating expenses..... 32,455 19,390 OPERATING LOSS..... (17,052) (8,184) Interest revenue, net (Note 13)..... 2 6 LOSS BEFORE INCOME TAXES..... (17,050) (8,178) Income tax benefit (Note 9)..... 1,364 245 NET LOSS..... (15,686) (7,933) ===== Components of other comprehensive income: Foreign currency translation adjustments..... 58 (95) COMPREHENSIVE LOSS..... (15,628) (8,028) ===== The accompanying notes are an integral part of these combined financial statements. F-51 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) CHANGES IN THE NET INVESTMENT OF THE PHILIPS GROUP NET INVESTMENT OF THE PHILIPS GROUP ----- IN THOUSANDS OF EURO'S BALANCE DECEMBER 31, 2000..... 972 Net cash transfer from Philips..... 13,548 Components of comprehensive income: Net loss..... (15,686) Foreign currency translation adjustments..... 58 BALANCE DECEMBER 31, 2001..... (1,108) Net cash transfer from Philips..... 9,826 Components of comprehensive income: Net loss..... (7,933) Foreign currency translation adjustments..... (95) BALANCE SEPTEMBER 29, 2002..... 690 The accompanying notes are an integral part of these combined financial statements F-52 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) COMBINED STATEMENTS OF CASH FLOWS YEAR ENDED NINE MONTHS ENDED DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Cash flows from operating activities: Net loss..... (15,686) (7,933) Adjustments to reconcile net income to net cash provided by (used in) operating activities: Deferred taxation..... (1,260) 25 Depreciation and amortization..... 607 266 Change in assets and liabilities: Accounts receivable, net..... 1,033 (1,544) Related parties, net..... 2 270 Inventory, net..... 851 (111) Other current assets..... 207 (378) Accounts payable..... (69) (178) Deferred income and other accrued liabilities..... (30) (144) Long-term provisions..... 85 69 Effect of exchange rate changes..... (38) (6) NET CASH USED IN OPERATING ACTIVITIES..... (14,298) (9,664) Cash flows from investing activities: Purchases of property, plant and equipment..... (201) (84) NET CASH USED IN INVESTING ACTIVITIES..... (201) (84) Cash flows from financing activities: Net cash transferred from Philips..... 13,606 9,731 Effect of exchange rate changes..... 4 (59) NET CASH PROVIDED BY FINANCING ACTIVITIES..... 13,610 9,672 Effect of exchange rate changes..... 34 65 NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS..... (855) (11) Cash and cash equivalents, beginning of period..... 878 23 Cash and cash equivalents, end of period..... 23 12 Supplementary information: Cash received from Philips for income taxes..... 9,897 105 Cash received from (paid to) Philips for interest..... (576) 2 The accompanying notes are an integral part of these combined financial statements F-53 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2001 AND SEPTEMBER 29, 2002 1. DESCRIPTION OF THE COMPANY AND BASIS OF PRESENTATION DESCRIPTION OF THE COMPANY PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (PSP), a division of Royal Philips Electronics N.V. (Philips and Philips Group) is active in the field of speech processing technology. Starting from the traditional tape-recorded dictation Philips in the past two decades has become a global leader in the field of speech processing, offering a wide portfolio of state-of-the-art products and technologies. Philips Speech Processing Telephony is offering speech-enabled services including directory assistance, interactive voice response and voice portal applications for enterprise customers, telephony vendors and carriers. Philips Speech Processing Voice Control is operating on the market for speech-enabled automotive and mobile products. It offers a product portfolio including small footprint speech recognition engines for embedded applications like voice controlled climate, navigation and entertainment features within cars as well as voice dialing within mobile phones. With presence in Aachen, Germany, Dallas, USA, and Taipei, Taiwan PSP is able to cover the global market with products supporting more than 40 languages and that can process a vocabulary of more than one million words. Royal Philips Electronics N.V., the Netherlands, and ScanSoft, Inc., of Peabody, MA, USA entered into a purchase agreement in which ScanSoft acquires the business, employees and intellectual property of Philips Speech Processing Telephony and Philips Speech Processing Voice Control . The transaction is expected to close during the first quarter of 2003. See note 17 for additional disclosure of the transaction. BASIS OF PRESENTATION The combined financial statements reflect the

financial position, results of operations, changes in net investment of the Philips Group, and cash flows of the PSP business unit of Philips as if PSP had been a separate entity for all periods presented. The combined financial statements have been prepared using Philips' historical basis for PSP's assets and liabilities and results of operations, which have been stated in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). All significant intercompany transactions and balances have been eliminated in preparation of the combined financial statements. Corporate overheads have been allocated to PSP from Philips at central, regional and local levels for amounts, including directors remuneration, marketing, management information systems, accounting and financial reporting, treasury, human resources, legal, tax and security, based on the net sales of PSP compared to the consolidated net sales of Philips. Management believes these allocations are reasonable. However, the costs of these services charged to PSP are not necessarily indicative of the costs that would have been incurred had PSP operated as an entity independent of Philips, or as an autonomous public company, for all periods presented. PSP purchases components used in the production process, as well as equipment and supplies under collective purchase agreements and purchase conditions negotiated by Philips. Management believes that the benefits derived from such agreements and conditions would unlikely have been obtained had PSP been a stand-alone company. The pension and other postretirement benefit costs attributable to PSP have been based on the charge incurred by individual operations in respect of specific plans of which employees of PSP are members. For the purposes of presentation of the combined financial statements, the participation in the Philips plans has been treated as participation in various multi-employer plans. The charges included in the combined financial statements reflect the arrangements of Philips and are therefore not necessarily indicative of the pension and other postretirement benefit costs had PSP been a stand-alone company. During the year F-54 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) ended December 31, 2001, PSP has benefited from contribution holidays with respect to certain over-funded Philips pension plans. During 2002 no contribution holidays existed anymore. Upon divestment, PSP will not benefit from any contribution holidays, as the employees will no longer participate in Philips' plans. Because in the past PSP was not a separate legal group of companies or a separate holding company within the Philips Group of companies, the proportion of share capital and reserves attributable to PSP has been shown in the combined balance sheets as part of the "Net investment of the Philips Group". For the purpose of these combined financial statements, interest charge is calculated based on the average rate of interest for long-term debt paid by Philips and the average amount of net investment of the Philips Group invested in PSP during the reporting periods, taking into account the debt-to-equity ratio reported by Philips during the reporting periods. In addition, PSP has a number of short-term balances with other Philips Group businesses. These balances arise from trading transactions and services or other items and have been aggregated on the combined balance sheets under the headings "Receivables from related parties" and "Payables to related parties". Historically, PSP's operations have been included in the combined income tax returns filed by Philips in each of the countries where PSP is located (country fiscal unity). Income tax expense in these combined financial statements has been calculated on an as if separate tax return basis. The current tax expense is assumed to be settled within the financial period following the period in which it arises. Tax effects that may arise from PSP's divestment from the Philips Group have not been reflected in PSP's combined financial statements. Other significant features of the PSP divestment from Philips are described in Note 17. The financial information included herein is not necessarily indicative of the combined results of operations, financial position, changes in the net investment of the Philips Group and cash flows of PSP in the future or what they would have been for the periods presented had PSP been a separate stand-alone entity. REPORTING CURRENCY The Euro is used as reporting currency. The financial statements of foreign operations are translated into euros. Assets and liabilities are translated using the exchange rates on the respective balance sheet dates. Income and expense items are translated at average rates during the period. 2. SUMMARY OF ACCOUNTING POLICIES CASH AND CASH EQUIVALENTS Historically, Philips manages cash and cash equivalents on a centralized basis. Cash receipts associated with PSP's business are transferred to Philips on a daily basis and Philips funds PSP's disbursements. These cash transactions are reflected in the caption "Net investment of the Philips Group". In certain countries, however, PSP has dedicated bank accounts, operating under periodic cash pooling with Philips. Furthermore, PSP entities have small amounts of petty cash. ACCOUNTS RECEIVABLE Accounts receivables are stated at face value, net of allowances for doubtful accounts. F-55 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) INVENTORY Finished goods inventories are valued at the lower of cost, as determined by the first-in, first-out (FIFO) method, or net realizable value. Provision is made for obsolescence. Work in process comprises deferred costs on uncompleted contracts. PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation is calculated using the straight-line method over the expected economic life of the asset. Costs related to maintenance activities are expensed in the period in which they are incurred. Following are the expected useful lives of the assets: Machines and installations..... from 5 to 10 years Other fixed assets..... from 3 to 5 years INTANGIBLE ASSETS Intangible assets consists of acquired intellectual property rights consisting of computer software for resale, which is being amortized on the straight-line method over 5 years. IMPAIRMENT OF LONG-LIVED ASSETS Through December 31, 2001, PSP evaluated the recoverability of its long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of". Whenever adverse events or changes in business climate result in the expected undiscounted future cash flows from the related asset being less than the carrying value of the asset, an impairment loss would be recognized for the excess of the carrying value of the assets over the expected discounted future cash flows. On January 1, 2002, PSP adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 amends existing guidance on asset impairment and provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held-for-sale; and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations, and changes the timing of recognizing losses on such operations. The adoption of SFAS No. 144 on January 1, 2002 did not have an impact on the Company's combined financial statements. INCOME TAXES Historically, PSP's operations have been included in the combined income tax returns filed by Philips in each of the countries where PSP is located (country fiscal unity). Income tax expense in these combined financial statements has been calculated on an as if separate tax return basis. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and

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liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets, including assets arising from loss carry forwards, are recognized if it is more likely than not that the asset will be realized. F-56 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) REVENUE RECOGNITION PSP recognizes revenue in accordance with Statement of Position 97-2, Software Revenue Recognition, as amended by Statement of Position 98-9, and the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements. Revenue from the sale of hardware and software to end users is recognized upon delivery, provided that no significant obligations remain, evidence of the arrangement exists, the fees are fixed or determinable, and collectibility of the related receivable is reasonably assured. Revenue from royalties on sales of PSP's products by original equipment manufacturers to third parties is recognized upon delivery to the third party when such information is available, or when notified by the reseller that such royalties are due as a result of a sale, provided that collectibility of the related receivable is reasonably assured. Revenue from maintenance contracts is recognized ratably over the contract term. Revenue from development of custom software is recognized on a completed contract basis. Accordingly, all project costs and progress payments are deferred until the project is complete. Any anticipated losses are recognized immediately. RESEARCH AND DEVELOPMENT AND CAPITALIZED SOFTWARE DEVELOPMENT COSTS Under SFAS No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", costs incurred in the research and development of software products are expensed as incurred until technological feasibility has been established. Once established, these costs would be capitalized. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, anticipated future gross product revenues, estimated economic life and changes in software and hardware technologies. In the year ended December 31, 2001 and the nine-month period ended September 29, 2002, costs eligible for capitalization were not material. PENSION AND OTHER POSTRETIREMENT BENEFITS PSP accounts for the cost of pension plans and postretirement benefits other than pensions in accordance with SFAS No. 87, "Employers Accounting for Pensions" and SFAS No. 106, "Employers Accounting for Postretirement Benefits Other Than Pensions", respectively. These plans are generally part of pension and postretirement benefit plans within Philips, and are accounted for by PSP as multi-employer plans. STOCK-BASED COMPENSATION PSP applies SFAS No. 123, "Accounting for Stock-Based Compensation", which allows companies which have stock-based compensation arrangements with employees to continue to apply the existing accounting required by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and to provide pro forma disclosure of the accounting results of applying the fair value method of SFAS No. 123. PSP accounts for stock-based compensation arrangements (related to Philips stock options granted to PSP employees) under the intrinsic value method of APB Opinion No. 25. USE OF ESTIMATES The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect reported amounts in the financial statements and the accompanying F-57 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) notes. While management bases its assumptions and estimates on the facts and circumstances known at the balance sheet date, actual results could materially differ from those estimates. ACCOUNTING STANDARDS NOT YET ADOPTED In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143). SFAS No. 143 requires PSP to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. PSP also records a corresponding asset, which is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. PSP is required to adopt SFAS No. 143 on January 1, 2003. PSP believes that the adoption of SFAS No. 143 will not have a material impact on its financial statements. In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" (SFAS No. 145). SFAS No. 145 provides for the rescission of several previously issued accounting standards, new accounting guidance for the accounting for certain lease modifications and various technical corrections to existing pronouncements that are not substantive in nature. SFAS No. 145 will be adopted on January 1, 2003, except for the provisions relating to the amendment of SFAS No. 13, "Accounting for Leases", which will be adopted as required for transactions occurring subsequent to May 15, 2002. PSP believes that the adoption of SFAS No. 145 will not have a material impact on its financial statements. In June 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities" (SFAS No. 146). SFAS No. 146 addresses significant issues regarding the recognition, measurement and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force (EITF) has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". The scope of SFAS No. 146 also includes (1) costs related to terminating a contract that is not a capital lease, and (2) termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred compensation contract. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. PSP believes that the adoption of SFAS No. 146 will not have a material impact on its financial statements. 3. ACCOUNTS RECEIVABLE Accounts receivable consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Trade accounts receivable..... 4,503 4,571 Allowance for doubtful accounts..... (1,467) (1,171) Total accounts receivable, net..... 3,036 4,580 F-58 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) 4. INVENTORY Inventory consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Work in process..... 606 568 Finished goods..... 225 235 Allowance for obsolescence..... (169) (30) Total inventory, net..... 662 773 5. OTHER CURRENT ASSETS Other current assets consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Royalties receivable..... 22 418

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Prepaid expenses and sundry receivables..... 218 200 Total Other current assets..... 240 618 6. PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 -----

----- IN THOUSANDS OF EURO'S Machines and installations..... 1,374 1,243 Other fixed assets..... 3,730 3,805 Accumulated depreciation..... (4,583) (4,660) Total property, plant and equipment, net..... 521 388 7. INTANGIBLE ASSETS Intangible assets consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Computer software for resale, gross..... 230 208 Accumulated amortisation..... (46) (73) Intangible asset, net..... 184 135 Amortization of computer software costs was E46 thousand and E27 thousand for the year ended December 31, 2001 and the nine-month period ended September 29, 2002, respectively. The estimated amortisation expense for the next three years is E36 thousand per year. F-59 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) 8. OTHER ACCRUED LIABILITIES Other accrued liabilities consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Salaries and wages, holiday allowance, year-end payment..... 1,245 1,376 Accrued holiday rights..... 335 377 Obligation towards former stock holders..... 196 177 Accrued sales tax..... 56 49 Accrued commercial costs..... 83 92 Others..... 238 278 Total other accrued liabilities..... 2,153 2,349 9. INCOME TAXES Historically, PSP's operations have been included in the combined income tax returns filed by Philips in each of the countries where PSP is located (country fiscal unity). The income tax expense reported and the determination of deferred tax assets to be realized in PSP's combined financial statements is based on an as if separate tax return basis. The following table presents the principal reasons for the difference between the effective income tax rate and statutory income tax rate in the Netherlands: YEAR ENDED NINE MONTHS ENDED DECEMBER 31, 2001 SEPTEMBER 29, 2002 ----- IN PERCENTAGES Statutory income tax rate in the Netherlands..... 35% 35% Foreign rate differentials..... 4% 3% Change in valuation allowance..... (31)% (34)% Others..... 0% (1)% Effective income tax rate..... 8% 3% F-60 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) The income tax expense is as follows: YEAR ENDED NINE MONTHS ENDED DECEMBER 31, 2001 SEPTEMBER 29, 2002 ----- IN THOUSANDS OF EURO'S Income (loss) before income taxes: The Netherlands..... 0 0 Foreign..... (17,050) (8,178) Income tax benefit (expense): Current taxes The Netherlands..... 0 0 Foreign..... 105 270 Deferred taxes The Netherlands..... 0 0 Foreign..... 1,259 (25) Income tax benefit..... 1,364 245 The sources of differences between the financial accounting and tax basis of PSP's assets and liabilities that give rise to the net deferred tax assets are as follows: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Deferred tax assets: Doubtful accounts..... 84 76 Accrued compensation..... 131 194 Taxes other than income taxes..... 84 20 Jubilee provision..... 19 21 Others..... 174 144 Property, plant and equipment..... 110 92 Net operating losses..... 29,436 31,330 TOTAL GROSS DEFERRED TAX ASSETS..... 30,038 31,877 Valuation allowance..... (29,978) (31,842) NET DEFERRED TAX ASSETS..... 60 35 Deferred tax liabilities: Fixed assets..... 27 27 Accruals..... 17 17 Others..... 8 8 TOTAL GROSS DEFERRED LIABILITIES..... 52 52 NET DEFERRED TAX ASSETS (LIABILITIES)..... 8 (17) Based upon an as if separate tax return basis, as at September 29, 2002 PSP has incurred E22.1 million of operating loss carry forwards expiring at various dates through 2022 and E56.8 million of operating loss carry forwards with no expiration date. F-61 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) The valuation allowance for deferred tax assets as of December 31, 2001 and September 29, 2002 was E30.0 million and E31.8 million, respectively. The net change in total valuation allowance for the year ended December 31, 2001 and the nine-month period ended September 29, 2002 was an increase of E4.1 million and E1.8 million, respectively. In assessing the realizability of deferred tax assets, PSP considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. PSP considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that PSP will realize the benefits of those deductible differences for which a valuation allowance has not been recorded. 10. LONG-TERM PROVISIONS Long-term provisions consisted of the following: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S Provision for pensions..... 199 265 Provision for jubilee benefit obligations..... 70 73 Total long-term provisions..... 269 338 11. PENSION AND OTHER POST RETIREMENT COSTS Employees of PSP participate in various defined benefit and defined contribution pension plans of the Philips Group. For the purposes of the preparation of these combined financial statements, PSP's participation in the Philips plans has been treated as participation in various multi-employer plans. Accordingly, the charges included in the combined financial statements may not be indicative of the pension and other post retirement costs had PSP been a stand alone entity. Pension premium charged for the year ended December 31, 2001 and the nine-month period ended September 29, 2002 were E86 thousand and E102 thousand, respectively. In addition to receiving pension benefits, PSP employees in certain countries participate in other postretirement benefit plans of the Philips Group. These other postretirement benefits under SFAS No. 106 are recorded at the country central level and charged out to the various local entities as part of human resource overhead (surcharge on salaries paid). The charge to PSP is approximately E13 thousand and E32 thousand for the year ended December 31, 2001 and the nine-month period ended September 29, 2002, respectively. 12. EQUITY INCENTIVE PLANS EXISTING PHILIPS INCENTIVE PLANS Philips has granted stock options on its ordinary shares to members of PSP's management and certain key employees under either a Euro (EUR) denominated plan or a United States Dollar (USD) denominated plan. Under Philips' plans, options are granted with an exercise price equal to the fair market value of the underlying

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ordinary shares on the date of grant. Options are subject to vesting periods typically of three years and expirations of five or ten years. A limited number of options have also been F-62 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) granted under variable plans, subject to achievement of certain financial objectives during multi-year performance cycles. Exercise of all options is restricted by Philips' rules on insider trading. STOCK-BASED COMPENSATION Pro forma net income information, as required by SFAS No. 123, has been determined as if PSP had accounted for employee share options granted to PSP's employees by Philips under SFAS No. 123's fair value method. The pro forma amounts below are not necessarily representative of the effects of share-based awards on future net income because the plans eventually adopted by PSP after divestment from Philips may differ from Philips share options plans. Accordingly future grants of employee stock options to PSP's employees may not be comparable to awards made to employees while PSP was a part of Philips. The pro forma effect of recognizing compensation expense in accordance with SFAS No. 123 would have been as follows: DECEMBER 31, SEPTEMBER 29, 2001 2002 -----

----- IN THOUSANDS OF EURO'S Net loss, as reported..... (15,686) (7,933) Pro forma net loss..... (15,802) (8,112) The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: DECEMBER 31, SEPTEMBER 29, 2001 2002 -----

(EUR -- DENOMINATED) Risk-free interest rate.....	4.66%	4.83%	Expected dividend yield.....	1.2%
1.2% Expected option life.....	5 yrs.	5 yrs.	Expected stock price volatility.....	49% 53% (USD -- DENOMINATED) Risk-free interest rate.....
4.77%	4.62%	Expected dividend yield.....	1.2%	1.2%
Expected option life.....	5 yrs.	5 yrs.	Expected stock price volatility.....	49% 49%

The assumptions were used for these calculations only and do not necessarily represent an indication of management's expectations of future development. F-63 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) The following table summarizes information about the number of Philips share options granted to PSP's employees, those outstanding at December 31, 2001 and September 29, 2002 and changes during the period: Fixed option plans: DECEMBER 31, 2001 SEPTEMBER 29, 2002 ----- WEIGHTED AVERAGE WEIGHTED AVERAGE SHARES EXERCISE PRICE SHARES EXERCISE PRICE ----- (IN EUR) (IN EUR) Options outstanding, beginning of period..... 3,200 43.18 9,325 33.77 Options granted..... 6,125 28.85 6,336 34.78 Options exercised..... Options forfeited..... Options outstanding, end of period... 9,325 33.77 15,661 34.18 Weighted average fair value of options granted during the year in EUR..... 14.75 16.27 (IN USD) (IN USD) Options outstanding, beginning of period..... 24,500 40.61 16,700 29.57 Options granted..... 11,950 25.68 8,892 30.70 Options exercised..... Options forfeited..... (19,750) 40.90 (1,250) 42.28 Options outstanding, end of period... 16,700 29.57 24,342 29.33 Weighted average fair value of options granted during the year in USD..... 11.90 13.48 Variable option plans: DECEMBER 31, 2001 SEPTEMBER 29, 2002 ----- WEIGHTED AVERAGE WEIGHTED AVERAGE SHARES EXERCISE PRICE SHARES EXERCISE PRICE ----- (IN EUR) (IN EUR) Options outstanding, beginning of period..... 3,200 43.18 9,325 33.77 Options granted..... 6,125 28.85 Options exercised..... Options forfeited..... Options outstanding, end of period... 9,325 33.77 9,325 33.77 Weighted average fair value of options granted during the year in EUR..... 14.75 (IN USD) (IN USD) Options outstanding, beginning of period..... 22,500 42.00 14,700 30.20 Options granted..... 11,950 25.68 Options exercised..... Options forfeited..... (19,750) 40.90 (1,250) 42.28 Options outstanding, end of period... 14,700 30.20 13,450 29.08 Weighted average fair value of options granted during the year in USD..... 11.90 F-64 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) The following table summarizes information about stock options outstanding at September 29, 2002: Fixed option plans: OPTIONS OUTSTANDING ----- OPTIONS EXERCISABLE WEIGHTED ----- NUMBER AVERAGE NUMBER OUTSTANDING AT REMAINING EXERCISABLE AT SEPTEMBER 29, EXERCISE PRICE CONTRACTUAL LIFE SEPTEMBER 29, WEIGHTED PRICE PER YEAR OF GRANT 2002 PER SHARE (YEARS) 2002 SHARE ----- (PRICE IN EUR) (PRICE IN EUR) 2000..... 3,200 42.90 - 45.90 7.99 -- -- 2001..... 6,125 24.35 - 29.14 8.57 -- -- 2002..... 6,336 34.78 9.54 -- -- (PRICE IN USD) (PRICE IN USD) 1999..... 2,000 24.96 6.75 2,000 24.96 2000..... 3,000 36.65 - 43.05 7.71 -- -- 2001..... 10,450 25.68 8.54 -- -- 2002..... 8,892 30.70 9.54 -- -- TOTAL..... 40,003 2,000 Variable option plans: OPTIONS OUTSTANDING ----- OPTIONS EXERCISABLE WEIGHTED ----- NUMBER AVERAGE NUMBER OUTSTANDING AT REMAINING EXERCISABLE AT SEPTEMBER 29, EXERCISE PRICE CONTRACTUAL LIFE SEPTEMBER 29, WEIGHTED PRICE PER YEAR OF GRANT 2002 PER SHARE (YEARS) 2002 SHARE ----- (PRICE IN EUR) (PRICE IN EUR) 2000..... 3,200 42.90 - 45.90 7.99 -- -- 2001..... 6,125 24.35 - 29.14 8.57 -- -- (PRICE IN USD) (PRICE IN USD) 2000..... 3,000 36.65 - 43.05 7.71 -- -- 2001..... 10,450 25.68 8.54 -- -- TOTAL..... 22,775 F-65 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) 13. TRANSACTIONS WITH RELATED PARTIES PSP sells products to and purchases certain products and services from Philips in the normal course of business. Transactions between PSP and Philips are effected at prices that are intended to reflect the market value of the products and services involved. The following table summarizes transactions between PSP and Philips: DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S STATEMENT OF OPERATIONS: Sales to Philips group..... 2,890 389 Interest revenue..... 2 6 Corporate overhead allocation..... 308 178 Corporate Research..... 3,058 1,458 DECEMBER 31, SEPTEMBER 29, 2001 2002 ----- IN THOUSANDS OF EURO'S BALANCE SHEET: Income taxes receivable (included in Receivables from related parties)..... 105 270 Trade accounts receivable from Philips Group..... 512 724 Trade accounts payable to Philips Group..... 1,541 2,023 Deferred income taxes..... 8 (17) Interest revenue in these combined financial statements is calculated based on the average rate of interest for long-term debt paid by Philips and the average amount of net investment of the Philips Group

invested in PSP during the reporting periods, taking into account the debt-to-equity ratio reported by Philips during the reporting periods. Income tax expense has been calculated on an as if separate tax return basis. Tax effects that may arise from PSP's divestment from the Philips Group have not been reflected in PSP's combined financial statements. Corporate overheads have been allocated to PSP from Philips at central, regional and local levels for amounts including, but not limited to, directors remuneration, marketing, management information systems, accounting and financial reporting, treasury, human resources, legal, tax and security, based on the net sales of PSP compared to the consolidated net sales of Philips. Management believes these allocations are reasonable. However, the costs of these services charged to PSP are not necessarily indicative of the costs that would have been incurred had PSP operated as an entity independent of Philips. Philips Corporate Research is contracted by PSP to perform certain research and development projects; the projects are determined on a yearly basis. The fee charged is reported under Research & Development expenses.

F-66 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED)

14. COMMITMENTS AND CONTINGENCIES PSP is potentially subject to lawsuits, claims and proceedings, which arise in the ordinary course of business. There are no such matters pending that PSP expects to be material in relation to its business, financial condition or results of operations. RENT AGREEMENTS PSP has entered into certain short-term contracts to rent office and warehouse facilities. The rent charged to income amounted to E1,112 thousand and E827 thousand for the year ended December 31, 2001 and the nine-month period ended September 29, 2002 respectively, of which E181 thousand and E201 thousand respectively relates to charges from Philips based on square meters occupied. The table below presents the amounts of rent payable under the present contracts for the upcoming periods. RENT AMOUNT ----- IN THOUSANDS OF EURO'S Remainder of year 2002..... 218 Year 2003..... 779 Year 2004..... 531 Year 2005..... 531 Year 2006..... 133 Year 2007 and later..... 0

15. GEOGRAPHICAL INFORMATION PSP operates and derives its revenue from all major regions in the world. The geographical location of property, plant and equipment and the geographical origin of revenues are as follows: AMERICAS EUROPE ASIA PACIFIC TOTAL ----- IN THOUSANDS OF EURO'S December 31, 2001 Net sales..... 7,883 9,446 1,362 18,691 Property, plant and equipment, net..... 129 378 14 521 September 29, 2002 Net sales..... 7,194 5,400 343 12,937 Property, plant and equipment, net..... 60 322 6 388

16. CONCENTRATION OF RISKS AND FINANCIAL INSTRUMENTS CONCENTRATION OF CREDIT RISK Credit risk represents the risk that a loss would be recognized at the reporting date if counter parties failed completely to perform as contracted. Financial instruments which potentially subject PSP to a concentration of credit risk consist principally of accounts receivable. Management believes it has adequately provided for the collection risk in PSP's trade accounts receivable by recording an allowance for doubtful accounts which reduces such amounts to their net realizable value. Due to the project nature of the speech processing business, PSP derives a substantial portion of its revenues from a limited number of customers. In the year 2001 and the nine-month period ended F-67 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) September 29, 2002, two and three customers, respectively accounted for more than 10% of revenues each, and in the aggregate for 28% and 32% of revenues, respectively. FINANCIAL INSTRUMENTS PSP's earnings, cash flows, and financial position are exposed to foreign currency risk from foreign currency denominated receivables, payables, forecasted transactions, as well as net investments in certain foreign operations. These items are denominated in various foreign currencies, including mainly the U.S. Dollar. PSP periodically assesses its foreign currency exchange risk exposure. As USA customers are invoiced from Dallas, USA, in US Dollars and European customers are invoiced from Aachen, Germany, in Euro the currency risk exposure is very limited. Accordingly, PSP does not enter into any hedging activities or purchase derivative instruments. During 2001, PSP recorded a net foreign currency transaction profit of E23 thousand and during the nine-month period ended September 29, 2002, a loss was recorded of E9 thousand, which is included in cost of sales. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES The carrying values of accounts receivable and accounts payable approximate fair value because of the short maturity of these instruments.

17. SUBSEQUENT EVENTS On October 7, 2002, Royal Philips Electronics N.V. and ScanSoft, Inc. signed a purchase agreement for the sale of PSP's business, assets and liabilities. All employees of PSP are expected to be hired by ScanSoft. The legal closing is expected to take place in the first quarter of 2003. To provide for an orderly transfer and transition of PSP from Philips to ScanSoft, various agreements will be executed that cover a wide range of matters, including but not limited to: - the transfer by Philips to ScanSoft of the business, employees, assets and liabilities associated with PSP's business (Purchase Agreement, Local Asset Transfer Agreements); - the transfer or license by Philips to ScanSoft of certain intellectual property rights (Technology Transfer and License Agreement, Trademark Transfer and License Agreement); - the provision by Philips of certain corporate and local human resource management, finance and accounting, housing, information technology and other services to ScanSoft (Transition Services Agreement). STOCK INCENTIVE PLANS The Philips stock options granted to the PSP employees will not be converted into options for shares of ScanSoft. Upon closing, PSP employees with outstanding exercisable options will have a limited period of time to exercise these options and all unvested options will be cancelled. In addition, ScanSoft has assumed no obligation towards the beneficiaries or towards Philips with respect to these outstanding Philips' stock options.

F-68 PHILIPS SPEECH PROCESSING TELEPHONY AND VOICE CONTROL (A DIVISION OF ROYAL PHILIPS ELECTRONICS N.V.) NOTES TO THE COMBINED FINANCIAL STATEMENTS -- (CONTINUED) PENSIONS AND OTHER POSTRETIREMENT BENEFITS In most countries PSP's employees have pension entitlements as part of their benefit packages, and as it is common practice that in offering transferring employees equivalent benefit packages, this equivalence also extends to pension rights. In fact there exists a compulsory European Directive obliging member states to implement legislation in each EC country to the effect that in case of transfer of a business, all pension entitlements will transfer with the transferred employees. In the Netherlands, this law has become effective on July 1, 2002. In some countries, the pension entitlements are part of a state scheme; in many countries, however, the entitlements are specifically related to Philips, and will require a per country approach on how to deal with pension rights going forward and the treatment of accrued rights in the past. There are legal requirements which will dictate a transfer of pension liabilities, but also if there is not a strict legal requirement, in many cases taking into account the justified interest of employees will be a precondition for a smooth transition process in terms of consultation with works council and unions. Pension entitlement for PSP's employees may be funded by way of a separate pension fund, with an insurance company or by way of a book reserve system. In case a book reserve system is used by Philips in a country, the pension liabilities will transfer to

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ScanSoft and Philips shall include a provision in the local balance sheet which is equal to the actuarial present value of pension rights accrued up to the effective date as calculated under the relevant local book reserve system concerned. In case of a dedicated Philips pension fund, transferred employees will either get a premium free policy or there will be a collective transfer of liabilities and assets under the terms and rules set by the pertaining pension fund.

F-69 FINANCIAL STATEMENTS OF THE SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. F-70 REPORT OF INDEPENDENT ACCOUNTANTS To the Board of Directors and Stockholders of ScanSoft, Inc.: We have audited the accompanying statement of assets and liabilities of the Speech and Language Technologies operations of Lernout & Hauspie Speech Products N.V. (the "Business" as defined in Note 1) as of September 30, 2001 and the related statement of revenue and direct operating expenses for the nine months ended September 30, 2001 (herein referred to as the "financial statements"). These financial statements are the responsibility of the management of ScanSoft, Inc. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The accompanying financial statements were prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission as described in Note 1 and are not intended to be a complete presentation of the Business' results of operations and financial position. In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities as of September 30, 2001 and the revenue and direct operating expenses (as described in Note 1 to the financial statements) for the nine months ended September 30, 2001, in conformity with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP September 6, 2002 Boston, Massachusetts

F-71 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. STATEMENT OF ASSETS AND LIABILITIES SEPTEMBER 30, 2001 (IN THOUSANDS)

Assets	138
Accounts receivable, net of allowance for doubtful accounts of \$767.....	\$ 7,703
Inventory.....	138
Prepaid expenses and other current assets.....	126
Property and equipment, net.....	4,160
Intangible assets, net of accumulated amortization of \$1,734.....	8,448
Total assets.....	\$20,575
LIABILITIES AND PARENT COMPANY INVESTMENT	Accounts payable..... 4,694
Accrued liabilities.....	4,383
Total liabilities.....	9,077
Commitments and contingencies (Note 7) Parent company investment.....	11,498
Total liabilities and parent company investment.....	\$20,575

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

F-72 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. STATEMENT OF REVENUE AND DIRECT OPERATING EXPENSES FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 (IN THOUSANDS)

Revenue.....	\$ 34,173
Direct operating expenses: Cost of revenue.....	4,439
Cost of revenue from amortization of intangible assets....	1,734
Research and development.....	28,440
Selling, general and administrative.....	32,742
Total direct operating expenses.....	67,355
Excess of direct operating expenses over revenue.....	\$(33,182)

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

F-73 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS 1. BASIS OF PRESENTATION General. The accompanying financial statements have been prepared pursuant to the transaction described below and present the assets and liabilities and the revenue and direct operating expenses of the Speech and Language Technologies operations of Lernout & Hauspie Speech Products N.V. ("L&H"), hereinafter defined as the "Business" or "SLT." SLT was a provider of speech and language software, which included the RealSpeak text-to-speech technology, Dragon speech recognition software and other speech and voice-related technologies aimed at the telecommunications, automotive and mobile device markets. L&H did not maintain SLT as a separate business unit, but rather operated the Business within Lernout & Hauspie Speech Products N.V. and several of its subsidiaries, the most significant of which was L&H Holdings USA. In November 2000, Lernout & Hauspie Speech Products N.V. and L&H Holdings USA, Inc. filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the District of Delaware. L&H NV also filed a bankruptcy proceeding in Ieper, Belgium. In order to facilitate the sale of its assets in connection with the bankruptcy proceedings, L&H segregated the SLT operations into eight speech and language technology asset groups. On December 7, 2001, ScanSoft, Inc. ("ScanSoft") entered into an Asset Purchase Agreement (the "Purchase Agreement") to acquire certain assets and intellectual property and assume certain liabilities of the Speech and Language Technologies operations of L&H. The acquisition was conducted in a closed auction proceeding and approved by the United States bankruptcy court on December 11, 2001. The acquisition was completed on December 12, 2001. Pursuant to the Purchase Agreement, ScanSoft acquired three of the eight asset groups of SLT: Dragon Naturally Speaking ("DNS"), Text to Speech ("TTS") and Automated Speech Recognition ("ASR"), which represented the majority of the revenue-generating assets of SLT. The net assets acquired by ScanSoft consisted of (1) patents, trademarks, trade names and products associated with the acquired speech and language technology assets of LH (2) customer contracts and relationships and certain obligations associated with such contracts; (3) rights to accounts receivable related to the customer contracts acquired; and (4) certain inventory, fixed assets and other liabilities. ScanSoft also hired 223 employees of the research and development, sales and marketing and general and administrative organizations of SLT. ScanSoft paid total consideration of \$41.3 million as follows: \$10.0 million in cash, 7.4 million shares of ScanSoft common stock valued at \$27.8 million (based on the average of the closing share price of the common stock 3 days before and after the proposed acquisition was announced) and a 9% promissory note in the principal amount of \$3.5 million to be repaid in installments of \$0.1 million of principal and interest quarterly commencing on March 15, 2002. All remaining principal and interest on the note is due and payable on December 15, 2004. On August 13, 2002, the U.S. Bankruptcy Court for the District of Delaware approved, without objection, ScanSoft's agreement with representatives of L&H Holdings USA and Lernout & Hauspie Speech Products N.V. to repurchase shares of ScanSoft common stock worth \$7.0 million at a share price equal to the average of the closing price for the 20 trading days beginning August 14, 2002, but no less than \$4.79 per share. In addition, ScanSoft agreed to issue up to 300,000 shares of common stock to the holders of approximately six million shares remaining in the event that Scansoft does not offer the remaining shares in a public offering by February 15, 2003, and 100,000 shares of

common stock if ScanSoft has not registered the remaining shares by February 15, 2003. Basis of Presentation. As described above, L&H did not operate SLT as a separate business unit, therefore, complete financial statements historically were not prepared for SLT. The accompanying financial statements were derived from the historical accounting records of L&H in order to present the statement of assets and liabilities as of September 30, 2001, and the statement of revenue and direct operating expenses for the nine months ended September 30, 2001, in accordance with accounting F-74 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) principles generally accepted in the United States of America. As noted above, the three asset groups acquired by ScanSoft represented the majority of the revenue-generating assets of SLT. Accordingly, the statement of assets and liabilities and the statement of revenue and direct operating expenses reflect all of the eight technology asset groups. All other assets, liabilities, revenues, and operating expenses of L&H were excluded from the financial statements, as they were not directly attributable to SLT. Direct operating expenses are comprised primarily of employee-related expenses, including employee salaries and benefits, and other direct costs related to the operations of the Business such as cost of revenue, advertising, depreciation and amortization. Direct operating expenses also include other operating expenses, including facilities and related costs, which were allocated to the Business based on the number of employees dedicated to the Business. Additionally, the Business relied on L&H for certain administrative, management and other support services, and the related expenses were also allocated to the Business based on the number of employees dedicated to the Business. Management believes the method used to allocate the direct operating expenses and other infrastructure and support costs is reasonable. L&H did not segregate indirect corporate expenses and interest income (expense); accordingly these items are not included in the financial statements of the Business. The statement of assets and liabilities includes liabilities which existed at the time of bankruptcy filing. No adjustment to reflect the ultimate settlement of these liabilities subsequent to September 30, 2001 has been reflected in these financial statements. The financial statements are therefore stated at historical cost. The financial statements were prepared to substantially comply with the rules and regulations of the Securities and Exchange Commission for business combinations and are not intended to be a complete presentation of the Business' financial position, results of operations and cash flows. The historical net assets and historical revenue and direct operating expenses of the Business could differ from those that would have resulted had the Business operated autonomously or as an entity independent of L&H. Furthermore, the financial statements reflect all of the operations of the Business; however, as described above, ScanSoft did not acquire all of the net assets of SLT, did not retain a significant number of personnel directly related to historical operations of the Business, and did not continue to operate the facilities previously used by the Business. Consequently, the historical operating results may not be indicative of the results of operations of the Business in the future. As described above, L&H did not maintain SLT as a separate business unit. More specifically, SLT was defined by L&H during 2001 in connection with bankruptcy proceedings. Since L&H did not have a policy of allocating certain assets and liabilities and income and expense balances to the Business, such amounts, as described above, have not been included in the financial statements. Consequently, a full balance sheet, statement of operations and stockholders' equity are impractical to prepare. Furthermore, a statement of cash flows is not presented because the Business did not maintain a cash balance and was dependent upon L&H for financing the cash flows of the operations. In accordance with Rule 3-06 of Regulation S-X, the statement of revenue and direct operating expenses is presented for the nine months ended September 30, 2001 in satisfaction of the requirement for one year of audited financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES REVENUE RECOGNITION Revenue was derived primarily from the sale of software products to end-users through distribution partners and value added resellers (VARs), royalty revenues from OEM partners, and license fees from direct sales of products to end-users. F-75 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) SLT applied the provisions of Statement of Position 97-2 "Software Revenue Recognition," as amended by Statement of Position 98-9 "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions" to all transactions involving the sale of software products. In addition, SLT applied the provisions of Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements." SLT sold software products to distributors and resellers who in turn sold the products to retailers and VARs. Title and risk-of-loss passed to the distributor upon shipment, at which time payment was generally due. Revenue from sales of products to distributors and resellers was recognized (i) upon shipment by the distributor or reseller to the VAR or (ii) upon shipment by the retailer to end-users of the products. Agreements with distributors and resellers provided for rights of return which, in the case of VARs, generally lapsed upon shipment to the VARs, and, in the case of sales to retailers, upon shipment to end-users. Provisions for product returns were recorded as a reduction of revenue. From late 2000 to mid-2001, SLT changed the distribution channel of its retail products from traditional distributors and resellers to republishers. Republishers had sole responsibility for the marketing, manufacturing and distribution of SLT's products to retailers. Under the republishing arrangements, SLT earned a royalty based on the sale price of its products by republishers to retailers, as reported by republishers. Republishing arrangements generated proportionately lower revenue than did traditional distribution channels since the seller received a royalty in lieu of the full sales price. Similarly, the direct costs, primarily manufacturing and marketing, were proportionately lower under republisher agreements than under agreements with traditional distributors and resellers. SLT entered into royalty-bearing agreements with original equipment manufacturers (OEMs) and recognized revenue for royalty fees based on actual royalties earned and reported. Revenue from the direct sales of licenses of SLT's software products to end-users was recognized upon delivery, provided that no significant obligations remained, evidence of the arrangement existed, the fees were fixed or determinable, and collectibility was reasonably assured. For arrangements with multiple elements (e.g., undelivered maintenance and support bundled with perpetual licenses), SLT allocated revenue to the delivered elements of the arrangement using the residual value method, deferring revenue for undelivered elements based on evidence of the fair value of those undelivered elements, which was specific to SLT. The vendor specific objective evidence of fair values for the ongoing maintenance and support obligations was based upon substantive renewal rates stated in the contractual arrangements. Maintenance and support revenue, which was not significant to the results of operations, was recognized ratably over the service period. SLT also entered into fixed-fee contracts for software and related services, which included significant customization or modification of the software. As a result, SLT recognized revenue on the percentage-of-completion basis of accounting. Under the percentage-of-completion basis of accounting, revenue was recognized as the work progressed in amounts estimated to equal the actual progress on the contract. In applying this method, SLT measured each project's percentage-of-completion by the ratio of labor hours incurred to date to the estimated total labor hours for the project. Losses on contracts were recorded in the period they are determined, and the related obligations to perform the remaining services

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were included in accrued liabilities. For contracts in which SLT was unable to reasonably estimate the cost to complete the contract, SLT recognized revenue upon completion of the contract. INVENTORY Inventory is stated at the lower of cost (determined on a first-in, first-out basis) or market value. At September 30, 2001, inventory consisted primarily of finished goods. F-76 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) PROPERTY AND EQUIPMENT Property and equipment are stated at cost. Major improvements are capitalized, while expenditures for maintenance, repairs, and minor improvements are charged to expense. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation and amortization are eliminated from the accounts and any resulting gain or loss is reflected in results of operations. Depreciation was computed using the straight-line method over the estimated useful lives of the assets for computer equipment, software, furniture, fixtures and office equipment. Leasehold improvements are depreciated over the term of the lease. INTANGIBLE ASSETS Intangible assets represent the original fair value of intangible assets resulting from prior business or asset acquisitions, adjusted for impairment charges to reduce the carrying value to its fair value at the time of the impairment charge. Intangible assets were amortized using the straight-line method over their estimated useful lives of 5 years. Amortization expense amounted to \$1.7 million for the nine months ended September 30, 2001. This amount is included in cost of revenue. IMPAIRMENT OF LONG-LIVED ASSETS The recoverability of long-lived assets is evaluated upon indication of possible impairment by measuring the carrying value of the assets against the related undiscounted future cash flows. When an evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value of the asset, the asset is adjusted to its estimated fair value by recording an impairment charge based on the excess of the carrying value of the assets over the discounted estimated cash flows. RESEARCH AND DEVELOPMENT Research and development costs were expensed as incurred. FOREIGN CURRENCY TRANSLATION The functional currencies for the Business were the U.S. Dollar and the Euro as determined by the location of the operation. The financial information recorded in the Euro was translated to U.S. dollars using the average exchange rate for the nine months ended September 30, 2001. Translation gains and losses were recorded as non-operating expense and therefore are not included in the statement of revenues and direct operating expenses. INCOME TAXES No provision for income taxes was provided in the accompanying statement of revenue and direct operating expenses because, on a separate return basis, the business would have generated a taxable loss. No tax benefit resulting from such taxable loss was recorded due to the uncertainty of realizing such tax benefit. There are no net deferred tax assets reflected in the accompanying statement of assets and liabilities because, on a separate return basis, a full valuation allowance would have been recorded due to the uncertainty of realization of the net assets. F-77 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) CONCENTRATION OF CREDIT RISK SLT sold its software products and services to channel partners or customers located mainly in North America, Europe, and Asia-Pacific. SLT did not require collateral from its customers. For the nine months ended September 30, 2001, no customer accounted for more than 10% of revenue. At September 30, 2001, two customers accounted for 21% and 17% of net accounts receivable, respectively. USE OF ESTIMATES The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities on the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. 3. PROPERTY AND EQUIPMENT Property and equipment consisted of the following at September 30, 2001 (in thousands):

USEFUL LIVES IN YEARS ----- Computer equipment and software.....	3	\$ 19,108
Furniture, fixtures and office equipment.....	5-7	5,633
Leasehold improvements.....	6	2,724
Accumulated depreciation.....	(23,305)	\$ 4,160

Depreciation expense associated with property and equipment was \$5.1 million for the nine months ended September 30, 2001. 4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES Accounts payable at September 30, 2001 include \$3.7 million of liabilities that existed prior to the bankruptcy filings during 2000. Accrued liabilities were comprised of the following at September 30, 2001 (in thousands):

Accrued employee compensation and benefits.....	\$2,546	
Obligations to perform services under customer development contracts.....	1,283	Accrued expenses.....
	554	Total accrued liabilities.....
	\$4,383	=====

5. INTERCOMPANY COST ALLOCATIONS AND PARENT COMPANY INVESTMENT Certain costs are allocated to the Business by the Parent, primarily related to certain facilities, infrastructure and support services. The estimated costs of such services have been allocated to the financial statements of the Business based on employee headcount of the Business proportionate to the headcount of the Parent. Management believes these allocations are reasonable. See Note 1. F-78 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) The Business obtained financing for its day-to-day operations from L&H (the "Parent"). Parent company investment represents these investments made by the Parent. Interest expense associated with the Parent's general corporate debt has not been included in the financial statements because amounts were neither charged nor allocated to the Business. 6. EMPLOYEE BENEFIT PLANS Employee benefit costs included in direct operating expenses comprise the cost of medical, dental, life insurance and other benefit costs. For U.S. employees, employee benefit costs included employer contributions to a retirement savings plan under Section 401(k) of the Internal Revenue Service, which covered substantially all U.S. employees who met minimum age and service requirements. Employer contributions represented a match of 50% of contributions made by employees through payroll deductions in amounts allowed up to 3% of an employee's salary. The employer contribution was capped at 50% of the statutory maximums. The 401(k) employer contribution associated with the SLT employees for the nine months ended September 30, 2001 was approximately \$150,000. 7. COMMITMENTS AND CONTINGENCIES OPERATING LEASES Operating leases for facilities were entered into by L&H. The Business' operations were conducted from several of these facilities which also supported other operations of L&H. Rent expense allocated to the Business was approximately \$3.0 million for the nine months ended September 30, 2001. COMMITMENTS AND CONTINGENCIES L&H entered into arrangements with third-parties under which L&H granted rights to the manufacturing, marketing and distribution of certain products of the Business. Under certain of these agreements, L&H granted rights to future products. As a result of the bankruptcy proceedings, and more specifically the transfer to ScanSoft of the rights to the same products and technologies, certain of these third parties claimed that L&H breached their respective contracts. Subsequent to the acquisition of the Business by ScanSoft, L&H, ScanSoft and certain of these third parties entered into settlement agreements which required payments by each of the parties. The total amount due to the third parties amounted to approximately

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\$2.2 million, of which L&H was obligated for approximately \$0.7 million. No amounts have been recorded in the historical financial statements of the Business at September 30, 2001 because the financial obligation arose in connection with the acquisition by ScanSoft on December 12, 2001. L&H established a Key Employee Retention Plan ("KERP") in order to retain certain employees during 2001. Under the KERP, L&H was obligated to make payments to employees, including SLT employees, only upon termination of employment due to the acquisition by a third party of the assets of L&H. The maximum KERP obligation related to SLT employees totaled \$3.0 million at September 30, 2001. F-79

SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) 8. SEGMENT INFORMATION SLT operated in one segment. The revenue and related cost of revenue SLT attributed to geographic areas (based on the location in which the sale was invoiced) was as follows for the nine months ended September 30, 2001 (in thousands):

	NORTH AMERICA	EUROPE	TOTAL
Revenue.....	\$25,105	\$9,068	\$34,173
Cost of revenue.....	3,315	1,124	4,439
Cost of revenue from amortization of intangible assets... --	1,734	1,734	3,468
Property and equipment, net.....	3,135	1,025	4,160

9. RECENTLY ISSUED ACCOUNTING STANDARDS In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141 ("SFAS 141"), Business Combinations and No. 142 ("SFAS 142"), Goodwill and Other Intangible Assets. SFAS 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets, including how goodwill and other intangible assets should be accounted for after they have been initially recognized. In addition, SFAS 142 includes provisions for the reclassification of certain existing recognized intangible assets, such as acquired workforce, into goodwill. SFAS 142 provides that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment; intangible assets with finite useful lives will continue to be amortized over their useful lives. SFAS 142 also provides specific guidance for testing goodwill for impairment. The statement is effective for acquisitions that are completed after June 30, 2002 and for existing acquisitions on January 1, 2002. The statement would not have had a significant impact on the Business' financial position or results of operations. In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). SFAS 144 superseded SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of and provides a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001. The statement would not have had a significant impact on the Business' financial position or results of operations. In November 2001, the Emerging Issues Task Force ("EITF"), a committee of the FASB, reached a consensus on EITF Issue 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)("EITF 01-9"). EITF 01-9 presumes that consideration from a vendor to a customer or reseller of the vendor's products is a reduction of the selling prices of the vendor's products and, therefore, should be characterized as a reduction of revenue when recognized in the vendor's income statement and could lead to negative revenue under certain circumstances. Revenue reduction is required unless consideration relates to a separate identifiable benefit and the benefit's fair value can be established, in which case such amounts may be recorded as operating expenses. EITF 01-9 would not have had a significant impact on the Business' results of operations. In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS No. 146"). This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, Liability Recognition for F-80 SPEECH AND LANGUAGE TECHNOLOGIES OPERATIONS OF LERNOUT & HAUSPIE SPEECH PRODUCTS N.V. NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) ("EITF 94-3"). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. EITF 94-3 allowed for an exit cost liability to be recognized at the date of an entity's commitment to an exit plan. SFAS 146 also requires that liabilities recorded in connection with exit plans be initially measured at fair value. The provisions of SFAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The statement would not have had a significant impact on the Business' financial position or results of operations. F-81

SCANSOFT, INC. UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS F-82

SCANSOFT, INC. UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS On October 7, 2002, ScanSoft, Inc. ("ScanSoft") entered into a definitive agreement with Royal Philips Electronics ("Philips") to acquire the Philips Speech Processing Telephony and Voice Control business units ("PSP") and related intellectual property. On January 30, 2003, we completed the acquisition of the Speech Processing Telephony and Voice Control business units of Royal Philips Electronics, and related intellectual property on the terms set forth in the purchase agreement dated October 7, 2002, as amended. As consideration for these business units and intellectual property, we paid 3.1 million euros in cash at closing, subject to adjustment in accordance with the provisions of the purchase agreement, as amended, and agreed to pay an additional 1.0 million euros in cash prior to December 31, 2003, issued a 5.0 million euro note due December 31, 2003 and bearing 5.0% interest per annum and issued a \$27.5 million three-year, zero-interest subordinated debenture, convertible at any time at Philips' option into shares of our common stock at \$6.00 per share. On December 12, 2001, ScanSoft acquired substantially all of the speech and language technologies operations ("SLT") of Lernout & Hauspie Speech Products N.V. and certain of its affiliates ("L&H"). Consideration for the transaction comprised \$10 million in cash, a \$3.5 million note due December 15, 2004 and 7.4 million shares of our common stock having a value of \$27.8 million. The operations acquired include text-to-speech, speech recognition and dictation, and voice control technologies. The unaudited pro forma financial information as of and for the nine months ended September 30, 2002 gives effect to the acquisition of PSP as if ScanSoft and PSP had been combined as of January 1, 2002 for statement of operations purposes and as of September 30, 2002 for balance sheet purposes. The SLT acquisition was consummated on December 12, 2001. Therefore, the balance sheet impact of the acquisition is reflected in the historical balance sheet of ScanSoft as of September 30, 2002. The unaudited pro forma combined statement of operations for the year ended December 31, 2001 gives effect to the acquisition by ScanSoft of SLT and the proposed acquisition of PSP as if the acquisitions had occurred on January 1, 2001, combining the statement of operations of ScanSoft and the statement of operations of PSP for the year ended December 31, 2001 and the statement of revenues and direct operating expenses of SLT for the nine months ended September 30, 2001 in satisfaction of one year of financial information in accordance with Rule 3-06 of Regulation S-X. The unaudited pro forma adjustments related to the acquisition of PSP are based on estimates and assumptions that are

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preliminary and have been made solely for purposes of developing such pro forma information. The estimated pro forma adjustments arising from the acquisition of PSP are derived from the estimates of the price to be paid for the acquisition and the estimated fair values of the assets acquired and liabilities assumed. The final determination of purchase price, fair value of the net assets acquired and resulting goodwill may differ significantly from that reflected in the pro forma statement of operations and balance sheet. No significant transactions occurred between ScanSoft and PSP or SLT and PSP for the year ended December 31, 2001 or for the nine months ended September 30, 2002 and no amounts were due to or from ScanSoft or PSP as of September 30, 2002. The historical PSP financial information has been derived from the audited financial statements of PSP included in this Registration Statement and have been translated from euros to US dollars using the exchange rates in effect at the end of the period for the balance sheet and using average exchange rates for the respective periods for the statements of operations. The pro forma information is presented for illustrative purposes only and is not necessarily indicative of the operating results or financial position that would have occurred if the transactions had been consummated as of January 1, 2001 or January 1, 2002, as applicable, for the statements of operations or September 30, 2002, for the balance sheet, nor is it necessarily indicative of future operating results or financial position. The unaudited pro forma combined financial information should be read in conjunction with the historical financial statements of ScanSoft, PSP, and SLT and related notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" of ScanSoft included elsewhere in this Registration Statement.

F-83 SCANSOFT, INC. UNAUDITED PRO FORMA COMBINED BALANCE SHEET SEPTEMBER 30, 2002 PRO FORMA PRO FORMA SCANSOFT PSP ADJUSTMENTS COMBINED

----- (IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS) ASSETS Current assets: Cash and cash equivalents..... \$ 14,382 \$ 12 \$(3,412)(1)(2) \$ 10,982 Accounts receivable, net..... 15,868 4,462 20,330 Receivables from related parties..... 1,238 705 (705)(2) 1,238 Inventory..... 1,562 753 2,315 Prepaid expenses and other current assets... 2,853 602 3,455 ----- Total current assets..... 35,903 6,534 (4,117) 38,320 Goodwill..... 63,308 29,560(1) 92,868 Other intangible assets, net..... 36,035 132 7,728(1)(2) 43,895 Property and equipment, net..... 2,933 378 3,311 Other assets..... 1,091 1,091 ----- Total Assets..... \$ 139,270 \$ 7,044 \$ 33,171 \$ 179,485 ===== LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable..... 5,541 655 6,196 Accrued expenses..... 11,695 2,000(1) 13,695 Deferred revenue..... 955 1,112 2,067 Note payable..... 227 227 Payables to related parties..... -- 1,971 (1,971)(1)(2) -- Other current liabilities..... 1,720 2,305 914(1)(2) 4,939 ----- Total current liabilities..... 20,138 6,043 943 27,124 Deferred revenue..... 278 278 Convertible debt..... -- 27,500(1) 27,500 Long-term note payable, net of current portion..... 3,101 5,400(1) 8,501 Other liabilities..... 819 329 1,148 ----- Total liabilities..... 24,336 6,372 33,843 64,551 ----- Stockholders' equity: Preferred stock, \$0.001 par value; 40,000,000 shares authorized; 3,562,238 shares issued and outstanding (liquidation preference \$4,631)..... 4,631 4,631 Common stock, \$0.001 par value; 140,000,000 shares authorized; 65,334,366 shares issued and 63,216,988 shares outstanding, respectively..... 65 65 Additional paid-in capital..... 269,822 269,822 Treasury stock, at cost; 2,117,378 shares... (8,031) (8,031) Deferred compensation..... (199) (199) Accumulated other comprehensive income..... 12 12 Net Investment of the Philips Group..... -- 672 (672)(2) -- Accumulated deficit..... (151,366) (151,366) ----- Total stockholders' equity..... 114,934 672 (672) 114,934 ----- Total Liabilities and Stockholders' Equity.... \$ 139,270 \$ 7,044 \$ 33,171 \$ 179,485 ===== See accompanying Notes to Unaudited Pro Forma Combined Financial Statements. F-84 SCANSOFT, INC. UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2001 PRO FORMA PRO FORMA ADJUSTMENTS ADJUSTMENTS PRO FORMA SCANSOFT SLT PSP SLT PSP COMBINED

----- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) Revenue, third parties..... \$ 56,647 \$ 34,173 \$ 14,165 \$(3,329)(12) \$ -- \$101,656 Revenue, related party..... 7,208 -- 2,591 -- -- 9,799 ----- Total revenue..... 63,855 34,173 16,756 (3,329) -- 111,455 ----- Costs and expenses: Cost of revenue..... 12,849 4,439 2,948 (41)(4) 20,195 Cost of revenue from amortization of intangible assets..... 14,192 1,734 -- 100(7) 630(3) 16,656 Research and development..... 13,968 28,440 12,114 -- 54,522 Selling general and administrative.... 26,449 32,742 16,982 76,173 Amortization of goodwill and other intangible assets..... 13,328 -- -- 889(3) 14,217 ----- Total costs and expenses..... 80,786 67,355 32,044 100 1,478 181,763 ----- Loss from operations.... (16,931) (33,182) (15,288) (3,429) (1,478) (70,308) Other (expense) income, net..... (263) -- 2 (315)(9) (226)(5)(6) (802) ----- Loss before income taxes..... (17,194) (33,182) (15,286) (3,744) (1,704) (71,110) Provision for (benefit from) income taxes.... (317) -- (1,223) -- 1,223(8) (317) ----- Net loss..... \$(16,877) \$(33,182) \$(14,063) \$(3,744) \$(2,927) \$(70,793) ===== Pro forma net loss per common share(10): Basic and diluted..... \$ (0.34) \$ (1.25) ===== Weighted average common shares used in pro forma net loss per share calculation(10): Basic and diluted..... 49,693 6,989(11) 56,682 See accompanying Notes to Unaudited Pro Forma Combined Financial Statements. F-85 SCANSOFT, INC. UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002 PRO FORMA PRO FORMA SCANSOFT PSP ADJUSTMENTS COMBINED

----- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) Revenue, third parties..... \$ 74,598 \$ 11,633 \$ -- \$ 86,231 Revenue, related party..... 3,586 361 -- 3,947 ----- Total revenue..... 78,184 11,994 -- 90,178 ----- Costs and expenses: Cost of revenue..... 12,937 1,605 (25)(4) 14,517 Cost of revenue from amortization of intangible assets..... 7,494 -- 467(3) 7,961 Research and development..... 21,310 7,300 -- 28,610 Selling general and administrative..... 32,051 10,676 42,727 Amortization of goodwill and other intangible assets..... 1,446 -- 667(3) 2,113 Restructuring and other charges..... 1,041 1,041 ----- Total costs and expenses..... 76,279 19,581 1,109 96,969 ----- Income (loss) from operations..... 1,905 (7,587) (1,109) (6,791) Other (expense) income, net..... (178) 6 (180)(5)(6) (352) ----- Income (loss) before income taxes..... 1,727 (7,581) (1,289) (7,143) Provision for (benefit from) income taxes..... (166) (227) 227(8) (166) ----- Net income (loss)..... \$ 1,893 \$(7,354) \$(1,516) \$(6,977) ===== Pro forma net loss per common share(10): Basic.....

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\$ 0.03 \$ (0.11) ===== Diluted..... \$ 0.03 \$ (0.11) ===== Shares used in pro forma net loss per share calculation(10): Basic..... 67,116 63,554 Diluted..... 72,451 63,554 See accompanying Notes to Unaudited Pro Forma Combined Financial Statements. F-86 SCANSOFT, INC. NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS 1. ACQUISITIONS On October 7, 2002, ScanSoft, Inc. ("ScanSoft") entered into a definitive agreement with Royal Philips Electronics ("Philips") to acquire the Philips Speech Processing Telephony and Voice Control business units ("PSP") and related intellectual property. On January 30, 2003, we completed the acquisition of the Speech Processing Telephony and Voice Control business units of Royal Philips Electronics, and related intellectual property on the terms set forth in the purchase agreement dated October 7, 2002, as amended. As consideration for these business units and intellectual property, we paid 3.1 million euros in cash at closing, subject to adjustment in accordance with the provisions of the purchase agreement, as amended, and agreed to pay an additional 1.0 million euros in cash prior to December 31, 2003, issued a 5.0 million euro note due December 31, 2003 and bearing 5.0% interest per annum and issued a \$27.5 million three-year, zero-interest subordinated debenture, convertible at any time at Philips' option into shares of our common stock at \$6.00 per share. On December 7, 2001, ScanSoft entered into an Asset Purchase Agreement (the "Purchase Agreement") to acquire certain assets and intellectual property and assume certain liabilities of L&H. The assets were purchased and liabilities assumed in a closed auction proceeding. The transaction was approved by United States bankruptcy court on December 11, 2001. The transaction was completed on December 12, 2001, and ScanSoft's results of operations include the activities related to the acquisition since that date. Pursuant to the Purchase Agreement, ScanSoft acquired patents, trademarks, trade names, products and customer contracts associated with certain of the speech and language technology assets of L&H. In addition, ScanSoft obtained rights to accounts receivable related to the customer contracts acquired and certain fixed assets. ScanSoft also hired 223 of the approximately 500 remaining employees from L&H. ScanSoft did not acquire any significant property and equipment or assume any leases for property and equipment or facilities. ScanSoft paid \$41.3 million in total consideration to the creditors as follows: \$10.0 million in cash. 7.4 million shares of ScanSoft's common stock valued at \$27.8 million (based on the average of the closing share price of our stock 3 days before and after the proposed acquisition was announced), and a 9% promissory note in the principal amount of \$3.5 million, to be repaid quarterly in installments of \$0.1 million of principal and interest commencing on March 15, 2002, for a total of eleven payments. All remaining principal and interest on the note is due and payable on December 15, 2004. ScanSoft incurred approximately \$1.0 million of costs related to the acquisition. On August 13, 2002, the U.S. Bankruptcy Court for the District of Delaware approved, without objection, ScanSoft's agreement with representatives of L&H Holdings USA. and Lernout & Hauspie Speech Products N.V. to repurchase shares of ScanSoft common stock worth \$7.0 million at a share price equal to the average of the closing price for the 20 trading days beginning August 14, 2002, but no less than \$4.79 per share. In addition, ScanSoft agreed to issue 150,000 shares of common stock to the holders of approximately six million shares remaining in the event ScanSoft does not offer the remaining shares in a public offering by December 15, 2002. ScanSoft further agreed to issue an additional 150,000 shares of common stock to the holders of approximately six million shares remaining in the event ScanSoft does not offer the remaining shares in a public offering by February 15, 2003, and 100,000 shares of common stock if ScanSoft has not registered the remaining shares by February 15, 2003. Additionally, if the consummation of this offering does not occur by January 1, 2003, the outstanding principal and interest under the \$3.5 million promissory note that ScanSoft issued in connection with the acquisition of the L&H operations would become immediately due and payable. F-87 SCANSOFT, INC. NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS -- (CONTINUED) 2. PRO FORMA ADJUSTMENTS Pro forma adjustments reflect only those adjustments which are factually determinable and, with respect to the PSP acquisition, do not include the impact of contingencies which will not be known until the later of the closing of the transaction or the resolution of the contingency. Pro forma adjustments include the following: (1) Adjustments to record the purchase accounting for the assets acquired and the liabilities assumed of PSP, subject to adjustment pending the completion of a post-closing review of the purchased net assets and resolution of certain contingencies. The pro forma information reflects the payment of \$3.4 million in cash at the exchange rate on January 30, 2003 of 1.00 euro equaling \$1.08, the issuance of a \$5.0 million euro note due December 31, 2003 and bearing 5.0% interest per annum and the issuance of a \$27.5 million three-year, zero-interest debenture, convertible at any time into shares of our common stock at \$6.00 per share. ScanSoft also has accounted for \$2.0 million for anticipated transaction fees, which include legal, accounting, due diligence, tax structuring and filing fees. The fair value of convertible debenture was determined to be \$27.5 million based on the present value of the expected cash outflows using ScanSoft's incremental borrowing rate and the results of a Black-Scholes option pricing calculation for the value of the conversion feature, using a fair value of ScanSoft common stock of \$3.50 per share, the closing price of ScanSoft's common stock just prior to the parties entering into the acquisition agreement. Deferred revenue is comprised of (i) progress payments made by customers under contracts for software licenses and services which represent significant customization or modification of the software, (ii) advance payments for services and (iii) up front payments for annual software maintenance agreements. ScanSoft will assume legal obligations under such contracts and will record the fair value of these obligations in its final purchase accounting. The fair value of deferred revenue may differ from the book value, however, our purchase price allocation is preliminary because additional information is required to accurately determine the fair value of the legal obligation that we assumed, certain of which was not available at closing. The pro forma adjustments do not include an adjustment to record the fair value of deferred revenue because there is not yet sufficient information to make a factually supportable pro forma adjustment. Under the terms of the purchase agreement, the purchase price is subject to adjustment based on a comparison of net assets at the closing date to the net assets of PSP set forth in the agreement. Also, as a result of the legal requirements related to labor matters in certain countries in which PSP operates, primarily Germany, severance costs associated with the restructuring actions described below are anticipated. ScanSoft will assume the legal obligations of Philips with respect to severance benefits of the PSP employees. Philips will reimburse ScanSoft for the costs associated with restructuring actions related to German employees up to 5.0 million euro through December 31, 2003. At the closing date, or as soon as practicable thereafter, ScanSoft will record a liability for restructuring costs and a related receivable for amounts to be reimbursed by Philips. To the extent that the total costs exceed 5.0 million euro as of or at any time prior to December 31, 2003, Philips will reimburse ScanSoft for one-third of the excess costs and ScanSoft will be responsible for the remaining two-thirds of any excess costs. The adjustment for any excess costs will be recorded as additional purchase consideration and recorded as goodwill. The acquisition of PSP by ScanSoft will give rise to the elimination of certain PSP personnel and excess facilities. ScanSoft anticipates headcount reductions will occur across all functional areas of the combined company. The total costs associated with the anticipated

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restructuring actions will be dependent upon the outcome of required negotiations with local labor councils, primarily in Germany. ScanSoft currently anticipates that the restructuring activities will result in severance and restructuring F-88 SCANSOFT, INC. NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS -- (CONTINUED) costs ranging from \$2.8 million to \$3.3 million. Of this amount, approximately \$1.8 million to \$2.3 million will be reimbursed by Philips. The remaining amounts will be recorded as additional purchase price in accordance with Emerging Issue Task Force No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." Had these actions taken place on January 1, 2002 they would have resulted in approximately \$4.8 million of reduced expenses for the nine months ended September 30, 2002. ScanSoft believes these planned restructuring actions are an integral component of the acquisition plan to enable the benefits of the combined companies to be optimized and the benefits of the acquisition to be realized. ScanSoft expects to complete these restructuring efforts within one year of the closing. A summary of the preliminary purchase price allocation is as follows (in thousands):

Estimated consideration: Cash.....	\$ 4,500	Note payable.....	5,400
Convertible debenture.....	27,500	Transaction costs.....	2,000
----- Total estimated purchase consideration.....			
\$39,400 =====			
Preliminary allocation of the purchase consideration: Net tangible assets acquired.....	\$ 1,980	Identifiable intangible assets.....	7,860
Goodwill.....	29,560	----- \$39,400 =====	

ScanSoft believes that the \$7.9 million of identifiable intangible assets will be allocated to patents and core technology and completed technology in the amount of \$6.1 million and the remaining \$1.8 million to customer relationships and other contractual agreements. The \$4.5 million in cash is payable as follows: \$3.4 million upon closing of the acquisition and \$1.1 million no later than December 31, 2003. (2) Adjustments to eliminate historical assets and liabilities of PSP that will not be acquired or assumed by ScanSoft including the \$12,000 of cash, \$0.7 million of amounts due from Philips, \$0.1 million of purchased software, \$2.0 million of payables to Philips, \$0.2 million of other liabilities and \$0.7 million of net investment of the Philips Group which will not be acquired or assumed by ScanSoft. (3) Adjustment to record amortization expense for the identifiable intangible assets. Finalization of the allocation of the purchase price to tangible and identifiable intangible assets acquired and liabilities assumed is preliminary pending completion of the transaction and collection of data to evaluate estimates of future revenues and earnings to determine a discounted cash flow valuation of certain intangibles that meet the separate recognition criteria of SFAS No. 141. ScanSoft expects this process and subsequent allocation of purchase price to be complete within 90 days of the closing of the transaction. ScanSoft's preliminary assessment is that the weighted average useful life of the patents and core technology and completed technology will be approximately 10 years and other acquired identifiable F-89 SCANSOFT, INC. NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS -- (CONTINUED) intangible assets will be approximately 2 years. The pro forma adjustments for amortization are based on the weighted average useful life using the straight-line method. A change in the allocation between patents and core technology and completed technology and goodwill of \$1,000,000 would result in a change in pro forma annual amortization expense of approximately \$0.1 million. A change in the allocation between the other acquired identifiable intangible assets and goodwill of \$1,000,000 would result in a change in pro forma annual amortization of expense of approximately \$0.5 million. An increase in the weighted average useful life of the patents and core technology and completed from ten years to eleven years would result in a decrease in the pro forma amortization expense of less of than \$0.1 million for both the year ended December 31, 2001 and the nine months ended September 30, 2002. A decrease in the weighted average useful life of the patents, core technology and completed from ten years to nine years would result in an immaterial decrease in the pro forma amortization expense of less of than \$0.1 million for both the year ended December 31, 2001 and the nine months ended September 30, 2002. An increase in the weighted average useful life of the other acquired identifiable intangible assets from two years to three years would result in a change in pro forma annual amortization expense of approximately \$0.3 million and \$0.2 million for the year ended December 31, 2001 and the nine months ended September 30, 2002. (4) Adjustment to eliminate amortization expense related to intangible assets of PSP existing prior to the proposed acquisition which will not be acquired by ScanSoft. Amortization expense of \$41,000 and \$25,000 was eliminated for the year ended December 31, 2001 and the nine months ended September 30, 2002, respectively. (5) Adjustment to record interest expense on the 5.0 million euro promissory note to be issued as partial purchase consideration for the acquisition, bearing interest at five percent per year, as if the consideration was issued on January 1, 2001. Interest expense for the year ended December 31, 2001 and for the nine months ended September 30, 2002 would have been \$224,000 and \$174,000, respectively. (6) Adjustment to eliminate interest recorded on intercompany balances between PSP and Philips. Interest income adjusted totaled \$2 thousand and \$6 thousand for the year ended December 31, 2001 and for the nine months ended September 30, 2002, respectively. (7) Adjustment to eliminate amortization expense included in the historical financial statements of SLT of \$1.7 million and to record the amortization of the fair value of other intangible assets recorded in the acquisition as if the acquisition had occurred on January 1, 2001. Intangible assets recorded in connection with the SLT acquisition included \$17.9 million of patents and core technology, \$3.1 million of trademarks and tradenames and \$21.4 million of goodwill. In accordance with SFAS No. 142, no goodwill amortization is reflected for ScanSoft's goodwill resulting from the acquisition of SLT. Other intangible assets are amortized using the straight-line method over their estimated useful lives of ten years for patents and core technology and twelve years for trademarks and tradenames. (8) Adjustment to eliminate income tax benefits recorded by PSP in its historical statements of operations which would not have been realized by ScanSoft had the acquisition occurred on January 1, 2001. (9) Adjustment to record additional interest expense related to the note payable issued in partial consideration for the SLT acquisition as if the acquisition had occurred on January 1, 2001. The interest rate on the note is 9%. The outstanding principal balance is assumed to be the original principal balance of \$3.5 million based on the payment schedule included in the note agreement. The accompanying unaudited pro forma combined statement of operations does not assume any permitted prepayments of principal. (10) The pro forma net loss per share and the shares used in pro forma net loss per share do not include the effects of the assumed conversion to common stock of the convertible debenture to be issued to F-90 SCANSOFT, INC. NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS -- (CONTINUED) Philips as partial purchase consideration for the PSP acquisition because the impact would be antidilutive. The total shares of common stock to be issued upon conversion of the debenture would be 4,583,333. (11) Adjustment to reflect the 7.4 million shares of common stock issued to L&H in connection with the SLT acquisition as if the acquisition had occurred on January 1, 2001. (12) Adjustment to eliminate historical SLT revenues associated with the five asset group ScanSoft did not acquire. No pro forma adjustments have been made to the operating expenses of SLT because it is impracticable to determine the amounts with individual asset groups of SLT. F-91 [PROSPECTUS FEBRUARY 10, 2003 LOGO] [ScanSoft Logo] 7,184,406 Shares Common Stock

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