

BITSTREAM INC
Form 10-Q
May 17, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2004

or

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER: 0-21541

BITSTREAM INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

04-2744890
(I.R.S. Employer
Identification No.)

245 First Street, 17th Floor, Cambridge, Massachusetts 02142-1270

(Address of principal executive offices)

Registrant's telephone number, including area code: (617) 497-6222

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12B-2 of the Exchange Act). Yes No

On May 12, 2004, there were 8,578,779 shares of Class A Common Stock, par value \$0.01 per share issued, including 125,809 issued and designated as treasury shares, and no shares of Class B Common Stock, par value \$0.01 per share, issued or outstanding.

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Table of Contents**BITSTREAM INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)**

| | March 31, 2004 | December 31, 2003 |
|--|---------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,205 | \$ 4,367 |
| Accounts receivable, net of allowance of \$26 at March 31, 2004 and December 31, 2003 | 825 | 1,016 |
| Prepaid expenses and other current assets | 248 | 61 |
| | <u> </u> | <u> </u> |
| Total current assets | 5,278 | 5,444 |
| | <u> </u> | <u> </u> |
| Property and equipment, net | 325 | 347 |
| | <u> </u> | <u> </u> |
| Other assets: | | |
| Restricted cash | 250 | 250 |
| Goodwill | 727 | 727 |
| Intangible assets | 231 | 243 |
| | <u> </u> | <u> </u> |
| Total other assets | 1,208 | 1,220 |
| | <u> </u> | <u> </u> |
| Total assets | \$ 6,811 | \$ 7,011 |
| | <u> </u> | <u> </u> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 284 | \$ 513 |
| Accrued expenses | 1,112 | 877 |
| Current portion of deferred revenue | 612 | 547 |
| | <u> </u> | <u> </u> |
| Total current liabilities | 2,008 | 1,937 |
| | <u> </u> | <u> </u> |
| Deferred rent | 204 | 135 |
| | <u> </u> | <u> </u> |
| Total liabilities | 2,212 | 2,072 |
| | <u> </u> | <u> </u> |
| Commitments and contingencies (Note 6) | | |
| Stockholders' equity : | | |
| Preferred stock, \$0.01 par value | | |
| Authorized 6,000 shares Issued and outstanding- 0 at March 31, 2004 and December 31, 2003, respectively | | |
| Common stock, \$0.01 par value | | |
| Authorized 30,500 shares Issued and outstanding- 8,579 and 8,573 at March 31, 2004 and December 31, 2003, respectively | 86 | 86 |
| Additional paid-in capital | 32,556 | 32,551 |
| Accumulated deficit | (27,683) | (27,338) |
| Treasury stock, at cost; 126 shares as of March 31, 2004 and December 31, 2003 | (360) | (360) |
| | <u> </u> | <u> </u> |

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| | | |
|--|----------|----------|
| Total stockholders' equity | 4,599 | 4,939 |
| Total liabilities and stockholders' equity | \$ 6,811 | \$ 7,011 |

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

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BITSTREAM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

| | Three Months Ended March 31, | |
|--|---|------------------|
| | 2004 | 2003 |
| Revenue: | | |
| Software licenses | \$ 2,284 | \$ 1,744 |
| Services | 446 | 288 |
| Total revenue | 2,730 | 2,032 |
| Cost of revenue: | | |
| Software licenses | 681 | 539 |
| Services | 180 | 137 |
| Cost of revenue | 861 | 676 |
| Gross profit | 1,869 | 1,356 |
| Operating expenses: | | |
| Marketing and selling | 693 | 720 |
| Research and development | 1,030 | 1,043 |
| General and administrative | 491 | 572 |
| Total operating expenses | 2,214 | 2,335 |
| Operating loss | (345) | (979) |
| Gain on investment in DiamondSoft, Inc. | | 93 |
| Interest and other income (expense), net | 28 | (10) |
| Loss before provision for income taxes | (317) | (896) |
| Provision for income taxes | 28 | 21 |
| Net loss | \$ (345) | \$ (917) |
| Basic and diluted net loss per share | \$ (0.04) | \$ (0.11) |
| Basic and diluted weighted average shares outstanding | 8,449 | 8,349 |

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

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BITSTREAM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

| | Three Months Ended March 31, | |
|---|---|-------------------|
| | 2004 | 2003 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (345) | \$ (917) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 45 | 55 |
| Amortization | 23 | 19 |
| Gain on investment in DiamondSoft, Inc. | | (93) |
| Loss on disposal of property and equipment | | 20 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 191 | 45 |
| Income tax receivable | | 134 |
| Prepaid expenses and other assets | (187) | (38) |
| Accounts payable | (229) | 176 |
| Accrued expenses | 235 | (80) |
| Deferred revenue (long and short term) | 65 | (106) |
| Other long term liabilities | 69 | |
| | <u> </u> | <u> </u> |
| Net cash used in operating activities | (133) | (785) |
| | <u> </u> | <u> </u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment, net | (23) | (44) |
| Additions to intangible assets | (11) | (13) |
| | <u> </u> | <u> </u> |
| Net cash used in investing activities | (34) | (57) |
| | <u> </u> | <u> </u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options | 5 | |
| | <u> </u> | <u> </u> |
| Net cash provided by financing activities | 5 | |
| | <u> </u> | <u> </u> |
| Net Decrease in Cash and Cash Equivalents | (162) | (842) |
| Cash and Cash Equivalents, beginning of period | 4,367 | 4,828 |
| | <u> </u> | <u> </u> |
| Cash and Cash Equivalents, end of period | \$ 4,205 | \$ 3,986 |
| | <u> </u> | <u> </u> |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$ 1 | \$ 1 |
| Cash paid (received) for income taxes | \$ 19 | \$ (120) |

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

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BITSTREAM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2004

(1) Significant Accounting Policies

Bitstream Inc. (Bitstream) together with its subsidiaries (collectively, the Company) develop and market software products and technologies to enhance the creation, transport, viewing and printing of electronic documents. Bitstream enables customers worldwide to render high-quality text, browse the Web on wireless devices, select from the largest collection of fonts online, and customize documents over the Internet. Its product lines include font technology, browsing technology, and publishing technology.

(a) Basis of Presentation

The consolidated financial statements of the Company presented herein, without audit, have been prepared pursuant to the rules of the Securities and Exchange Commission (the SEC) for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures required by generally accepted accounting principles. The balance sheet information at December 31, 2003 has been derived from the Company s audited consolidated financial statements. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2003 included in the Company s Annual Report on Form 10-K, which was filed by the Company with the SEC on March 30, 2004. The balance sheet as of March 31, 2004, the statements of operations for the three months ended March 31, 2004 and 2003, the statements of cash flows for the three months ended March 31, 2004 and 2003, and the notes to each are unaudited, but in the opinion of management include all adjustments necessary for a fair presentation of the consolidated financial position, results of operations, and cash flows of the Company for these interim periods.

The results of operations for the three months ended March 31, 2004 may not necessarily be indicative of the results to be expected for the year ending December 31, 2004.

(b) Disclosures about Segments of an Enterprise

In connection with a recent reorganization of its sales and marketing forces and the elimination of the General Manager position for its Pageflex, Inc. subsidiary, the Company reassessed the segment disclosure requirements of SFAS No. 131 *Disclosure about Segments of an Enterprise and Related information*. As a result of these changes, during 2004, the Company has changed the manner in which it measures and reports its financial results and reports to the Board of Directors. Prior to January 1, 2004 the Company s CEO, its chief operating decision-maker, assessed individual performances based upon discreet financial information on three segments: Type, MyFonts, and Pageflex. The Company now views its operations and manages its business as principally one segment with three major product lines: fonts and font technology, browsing, and publishing. Prior year segment disclosure has been modified to conform with the current year classification.

(c) Revenue Recognition

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The Company recognizes revenue in accordance with Statement of Position 97-2 (SOP 97-2), *Software Revenue Recognition*, as modified by SOP 98-9, *Modifications of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. The Company derives revenues from the license of its software products, professional consulting, and support and maintenance services. License revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable, and collection of the fee is probable.

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BITSTREAM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Licensing fees and royalty revenue include: (1) payments by Original Equipment Manufacturer (OEM) and Independent Software Vendor (ISV) customers for text imaging and page layout technologies; (2) direct and indirect licenses of software publishing applications for the creation, enhancement, management, transport, viewing and printing of electronic information; (3) direct sales of custom and other type products to end users such as graphic artists, desktop publishers and corporations; and (4) sales of type products to foreign customers primarily through distributors.

Certain OEM and ISV customers pay royalties only upon the sublicensing of the Company's products to end-users. License revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable, and collection of the fee is probable. Revenue from guaranteed minimum royalty licenses is recognized upon delivery of the software license when no further obligations of the Company exist, while revenue on pay-as-you-go licenses is recognized in the period when sublicenses to end users are reported to the Company by the OEM or ISV customer. In certain guaranteed minimum royalty licenses, the Company will enter into extended payment programs with creditworthy customers. Revenue related to extended payment programs is recognized when payment becomes due to the Company.

The Company recognizes license revenue from the resale of its products through various resellers. Resellers may sell the Company's products in either an electronic format or physical CD product format. Revenue is recognized if collection is probable, upon notification from the reseller that it has sold the product or if for a physical product, upon delivery of the software.

Revenue from end user product sales is recognized upon delivery of the software, net of estimated returns and allowances, and if collection is probable. Provisions for any estimated losses on uncompleted contracts are made in the period in which such losses become probable. Revenue related to extended payment programs is recognized when payment becomes due to the Company. End user sales include e-commerce revenue generated from the Company's Web sites from the licensing of Bitstream fonts, font technology and the ThunderHawk browser, licensing of fonts and font technology developed by third parties and from fees received from referring customers to other sites for which we have referral agreements. Referral revenue is recognized at the net amount received by Bitstream and for each of the three months ended March 31, 2004 and 2003 was \$3. There are minimal costs associated with the Referral Fee program, which represent the time to load copies of the fonts provided by each participating foundry for addition to the MyFonts.com database, and the Company expenses those costs as incurred.

The Company recognizes revenue under multiple-element arrangements using the residual method when vendor-specific objective evidence of fair value exists for all of the undelivered elements under the arrangement. Under the residual method, the arrangement consideration is first allocated to undelivered elements based on vendor-specific objective evidence of the fair value for each element and the residual amount is allocated to the delivered elements. Arrangement consideration allocated to undelivered elements is deferred and recognized as revenue when the elements are delivered, if all other revenue recognition criteria are met. The Company has established sufficient vendor-specific objective evidence for the value of its consulting, training, and other services, based on the price charged when these elements are sold separately. Accordingly, software license revenue is recognized under the residual method in arrangements in which software is licensed with consulting, training or other services.

Professional services include custom design and development and training. The Company recognizes professional services revenue under software development contracts as services are provided for per diem contracts or by using the percentage-of-completion method of accounting for long-term fixed price contracts. Provisions for any estimated losses on uncompleted contracts are made in the period in which such losses become probable.

Table of Contents**BITSTREAM INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company recognizes revenue from support and maintenance agreements ratably over the term of the agreement.

Deferred revenue includes unearned software maintenance revenue, certain prepaid royalties and advance billings under software development contracts.

Cost of revenue from software licenses consists primarily of royalties paid to third party developers and foundries whose products the Company sells, and costs to distribute the product, including the cost of the media on which it is delivered. Cost of revenue from services consists primarily of costs associated with customer support, consulting and custom product development services.

The Company generally warrants that its products will function substantially in accordance with documentation provided to customers for approximately 90 days following initial delivery. The Company has not incurred any expenses related to warranty claims.

(d) Accounting For Stock-Based Compensation

The Company accounts for its employee stock plans using the intrinsic value method. The SFAS 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment to Statement of Financial Accounting Standards No. 123*, disclosures include pro forma net income and earnings per share as if the fair value-based method of accounting had been used. Stock issued to non-employees is accounted for in accordance with SFAS 123 and related interpretations. The following table sets forth the pro forma amounts of net loss and net loss per share that would have resulted if the Company accounted for its employee stock plans under the fair value recognition provisions of SFAS 123, *Accounting for Stock-Based Compensation* (in thousands, except per share amounts):

| | Three Months Ended March 31, | |
|--|---|-------------------|
| | 2004 | 2003 |
| | <u> </u> | <u> </u> |
| Net loss: | | |
| As reported | \$ (345) | \$ (917) |
| Deduct: Total stock based compensation expense determined under the fair value based method for all grants, net of related tax effects | 201 | 278 |
| | <u> </u> | <u> </u> |
| Pro forma | <u>\$ (546)</u> | <u>\$ (1,195)</u> |
| | <u> </u> | <u> </u> |
| Basic and diluted net loss per share: | | |