

ACTUATE CORP
Form 10-Q
May 06, 2004
Table of Contents

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 No. 0-24607

Actuate Corporation

(Exact name of Registrant as specified in its charter)

Delaware
(State of incorporation)

94-3193197
(I.R.S. Employer Identification No.)

701 Gateway Boulevard

South San Francisco, California 94080

(650) 837-2000

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

Former name, former address and former fiscal year, if changed since last report: None

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

Edgar Filing: ACTUATE CORP - Form 10-Q

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

<u>Title of Class</u>	<u>Outstanding as of March 31, 2004</u>
Common Stock, par value \$.001 per share	61,491,368

Table of Contents

Actuate Corporation

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements:

Condensed Consolidated Balance Sheets as of March 31, 2004 and December 31, 2003 3

Condensed Consolidated Statements of Operations for the three months ended March 31, 2004 and 2003 4

Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2004 and 2003 5

Notes to Condensed Consolidated Financial Statements 6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 13

Item 4. Evaluation of Disclosure Controls and Procedures 18

PART II OTHER INFORMATION

Item 1. Legal Proceedings 29

Item 6. Exhibits and Reports on Form 8-K 29

Signature 30

Table of Contents**Part I. Financial Information****Item 1. Financial Statements**

ACTUATE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	March 31,	December 31,
	2004	2003
	<u> </u>	<u> </u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 25,268	\$ 8,950
Short-term investments	20,600	36,489
Accounts receivable, net	19,588	20,208
Other current assets	2,658	2,599
	<u> </u>	<u> </u>
Total current assets	68,114	68,246
Property and equipment, net	4,974	5,097
Goodwill, net	20,766	20,766
Other purchased intangibles, net	5,094	5,759
Other assets	1,195	1,538
	<u> </u>	<u> </u>
	<u>\$ 100,143</u>	<u>\$ 101,406</u>
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 2,134	\$ 2,758
Current portion of restructuring liabilities	2,517	2,198
Accrued compensation	4,287	4,402
Other accrued liabilities	4,817	4,772
Income taxes payable	1,228	1,241
Deferred revenue	25,556	25,790
	<u> </u>	<u> </u>
Total current liabilities	40,539	41,161
	<u> </u>	<u> </u>
Restructuring liabilities, net of current portion	14,494	15,064
Stockholders equity	45,110	45,181
	<u> </u>	<u> </u>
	<u>\$ 100,143</u>	<u>\$ 101,406</u>



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

Table of Contents

ACTUATE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended	
	March 31,	
	2004	2003
Revenues:		
License fees	\$ 11,477	\$ 10,856
Services	14,191	14,274
Total revenues	25,668	25,130
Costs and expenses:		
Cost of license fees	1,100	611
Cost of services	6,089	5,903
Sales and marketing	10,294	11,188
Research and development	5,191	4,569
General and administrative	2,673	3,742
Amortization of other intangibles	282	770
Restructuring charges	586	
Total costs and expenses	26,215	26,783
Loss from operations	(547)	(1,653)
Interest and other income, net	170	159
Loss before income taxes	(377)	(1,494)
Income tax benefit		(658)
Net loss	\$ (377)	\$ (836)
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)
Shares used in basic and diluted net loss per share calculation	61,358	60,227

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

Table of Contents

ACTUATE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	Three Months Ended March 31,	
	2004	2003
Operating activities		
Net loss	\$ (377)	\$ (836)
Adjustments to reconcile net loss to net cash from operating activities:		
Amortization of deferred compensation		26
Amortization of other intangibles	665	996
Depreciation	574	843
Changes in operating assets and liabilities:		
Accounts receivable	620	2,890
Other current assets	(59)	668
Accounts payable	(625)	1,301
Accrued compensation	(115)	(1,026)
Other accrued liabilities	45	656
Income tax (receivable)	(13)	(655)
Restructuring liabilities	(251)	(1,186)
Deferred revenue	(234)	(366)
Net cash provided by operating activities	230	3,311
Investing activities		
Purchases of property and equipment	(451)	(479)
Proceeds from maturity of short-term investments	29,388	12,028
Purchases of short-term investments	(13,499)	(14,421)
Net change in other assets	343	(187)
Net cash provided by (used in) investing activities	15,781	(3,059)
Financing activities		
Proceeds from issuance of common stock	426	1,344
Net cash provided by financing activities	426	1,344
Net increase in cash and cash equivalents	16,437	1,596
Effect of exchange rate on cash	(119)	(31)
Cash and cash equivalents at the beginning of the period	8,950	23,595
Cash and cash equivalents at the end of the period	\$ 25,268	\$ 25,160

Edgar Filing: ACTUATE CORP - Form 10-Q

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

Table of Contents

ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying interim condensed consolidated financial statements of Actuate Corporation are unaudited and include all normal recurring adjustments and non-recurring adjustments which we believe to be necessary for the fair presentation of the financial position, results of operations, and changes in cash flows for the periods presented. Our first quarter of fiscal year 2004 results include a non-recurring restructuring charge of \$586,000 associated with our French operation. Our results for the period ended March 31, 2003 included approximately \$1.6 million in legal fees related to our trial with MicroStrategy, which did not recur in the current quarter. The preparation of the financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Despite our best effort to establish good faith estimates and assumptions, actual results may differ.

The interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2003 as filed with the Securities and Exchange Commission on March 11, 2004. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. Interim results of operations for the three months ended March 31, 2004 are not necessarily indicative of operating results for the full fiscal year.

Revenue Recognition

We generate revenues from sales of software licenses and related services. We receive software license revenues from licensing our products directly to end-users and indirectly through resellers, system integrators and original equipment manufacturers (OEMs). Our products do not require significant customization. The majority of end-user license revenues are derived from end-user customer orders for specific individual products. We receive service revenues from maintenance contracts, consulting services and training that we perform for customers.

We recognize revenues in accordance with AICPA Statement of Position (SOP) 97-2 (SOP 97-2), *Software Revenue Recognition*, as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. For sales to end-user customers, we recognize license revenues when a license agreement has been signed by both parties or a definitive purchase order has been received from the customer, the product has been shipped, there are no uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. We have not established vendor specific objective evidence of fair value for license fees and; therefore, we recognize revenues from arrangements with multiple elements involving software licenses under the residual method. If the license agreement contains payment terms that would indicate that the fee is not fixed or determinable, revenues are recognized as the payments become due, assuming that all other revenue recognition criteria are

Table of Contents

met. For arrangements in which the contracting entity has the right to the unlimited usage of our products for a specified term and the right to unspecified future products, license fee revenues are deferred and recognized on a straight-line basis over the term of the license agreement.

We enter into reseller and distributor arrangements that typically give such distributors and resellers the right to distribute our products to end-users headquartered in specified territories. We recognize license revenues from arrangements with the U.S. resellers and distributors when there is persuasive evidence of an arrangement, the product has been shipped, the fees are fixed or determinable and collectibility is probable. We recognize license fee revenues from arrangements with international resellers and distributors upon receipt of evidence of sell-through and when all other revenue recognition criteria have been met. If it is not practical to obtain evidence of sell-through, we defer revenues until the end-user has been identified and cash has been received.

We also enter into OEM arrangements that provide for license fees based on a specified duration and the bundling or embedding of our products with the OEMs' products. These arrangements generally provide for fixed, irrevocable royalty payments. We recognize license fee revenues from the OEM arrangements when a license agreement has been signed by both parties, the product has been shipped, there are no uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement; and, for sales through international OEMs, we defer revenue until we receive a royalty report from the customer.

Credit-worthiness and collectibility for end-users, resellers, distributors and OEMs are first assessed on a country level and then, for those customers in countries deemed to have sufficient timely payment history; customers are assessed based on payment history and current credit profile. When a customer is not deemed credit-worthy, revenues are deferred and recognized upon cash receipt.

We recognize maintenance revenues, which consist of fees for ongoing support and unspecified product updates, ratably over the term of the contract, typically one year. Consulting revenues are primarily related to implementation and configuration. Training revenues are generated from classes offered at our headquarters and customer locations. Revenues from consulting and training services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is recognized on delivery of the software and all other revenue recognition criteria are met, provided services do not include significant customization or modification of the base product and are not otherwise essential to the functionality of the software.

Stock-Based Compensation

We have not adopted the recognition provisions of SFAS 123, as amended by SFAS 148, and continue to account for stock-based compensation under the intrinsic value method of Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees*, (APB 25) and related Interpretations. Accordingly, no compensation expense is recognized for stock options issued to employees since the strike price equals the market price on the date of grant for all options issued.

Table of Contents

The following table illustrates the effect on net loss and net loss per share if we had applied the fair value recognition provisions of SFAS 123, as amended by SFAS 148, to stock-based employee compensation (in thousands, except per share data):

	Three Months Ended March 31,	
	2004	2003
Net loss as reported	\$ (377)	\$ (836)
Add: Stock-based employee compensation expense, included in the determination of net loss as reported		26
Less: Stock-based employee compensation expense determined under the fair value method for all awards	(2,317)	(5,986)
Net loss pro forma	\$ (2,694)	\$ (6,796)
Basic and diluted net loss per share:		
As reported	\$ (0.01)	\$ (0.01)
Pro forma	\$ (0.04)	\$ (0.11)

The pro forma amounts disclosed above may not be representative of the effects on pro forma results in future years as options vest over several years, additional awards may be granted and awards may be cancelled in subsequent years.

Net Loss Per Share

Basic net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common and dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of the shares issuable upon the exercise of stock options (using the treasury stock method).

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2004	2003
Numerator:		
Net loss	\$ (377)	\$ (836)
Denominator:		
Weighted-average common shares outstanding	61,358	60,227

Edgar Filing: ACTUATE CORP - Form 10-Q

Weighted-average shares subject to repurchase		
Denominator for basic and diluted net loss per share	61,358	60,227
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)

All outstanding stock options have been excluded from the calculation of diluted net loss per share in the three months ended March 31, 2004 and 2003, because all such stock options are anti-dilutive. The weighted-average number of common shares excluded from the calculation of diluted net loss per share was 19,764,000 and 13,249,000 in the three months ended March 31, 2004 and 2003, respectively. Such stock options, had they been dilutive, would have been included in the computation of diluted net loss per share using the treasury stock method.

Table of Contents**Comprehensive Loss**

Comprehensive loss includes foreign currency translation adjustments and other unrealized losses on short-term investments that are excluded from net loss and are reflected as changes in equity. A summary of comprehensive loss is summarized as follows (in thousands):

	Three Months Ended	
	March 31,	
	2004	2003
Net loss	\$ (377)	\$ (836)
Foreign currency translation adjustment	(119)	(17)
Unrealized loss on available-for-sale securities		(4)
Comprehensive loss	\$ (496)	\$ (857)

Reclassifications

The amortization charge for purchased technology has been reclassified from Amortization of other intangibles to Cost of license fees for all of the periods presented. The reclassifications had no impact on the results of operations or stockholders' equity for the periods presented.

2. Restructuring Charges

In response to the deteriorating global economic conditions, we committed to a facility exit plan in the third quarter of fiscal year 2002. The primary goal of this restructuring plan was to reduce costs and improve operating efficiencies in order to adjust to then existing business and economic environment. Specifically, it was our decision, under this plan, to eliminate excess facility capacity in light of our revised facility requirements. As a result of this restructuring plan, we recorded an initial charge of \$27.1 million (consisting of a \$24.8 million idle facility charge and a \$2.3 million workforce reduction charge) during the fiscal year 2002.

The facility exit charge was calculated using management's best estimates and included \$21.5 million of estimated future obligations for non-cancelable lease payments (net of \$10.2 million of estimated sublease income) and estimated costs associated with subleasing the property (e.g., leasing commissions). The facility had been idle since the leasing term began in May 2001 and we formally made a decision to exit this facility during the third quarter of fiscal year 2002. As of March 31, 2004, \$16.7 million of lease exit costs, net of anticipated sublease income, remain accrued and will be fully utilized by fiscal year 2011. In calculating the facility exit charge, certain assumptions were made. Actual future cash requirements may differ materially from the accrual at March 31, 2004, particularly if the actual sublease income is significantly different from current estimates or if we are unsuccessful in our efforts to sublease the facility for the entire term of the lease (through fiscal year 2011).

Edgar Filing: ACTUATE CORP - Form 10-Q

In the first quarter of fiscal 2004 we initiated a restructuring of our French operation to size the operation to meet the expected business and economic environment for our products in France and to shift our sales strategy in France from one based primarily on direct sales to a strategy more dependent on indirect sales channels. This restructuring resulted in a workforce reduction of five total personnel and associated severance, benefit and related legal costs of \$586,000 during the first quarter of 2004.

The following table summarizes the analysis of the restructuring accrual activity during the three months ended March 31, 2004 (in thousands):

		Severance & Benefits	Facility Related	Total
		<u> </u>	<u> </u>	<u> </u>
Total accrual balance	December 31, 2003	\$	\$ 17,262	\$ 17,262
Accrual adjustments		586		586
Cash payments, net		(285)	(552)	(837)
		<u> </u>	<u> </u>	<u> </u>
Total accrual balance	March 31, 2004	301	16,710	17,011
Less: current portion		(301)	(2,216)	(2,517)
		<u> </u>	<u> </u>	<u> </u>
Long-term portion	March 31, 2004	\$	\$ 14,494	\$ 14,494
		<u> </u>	<u> </u>	<u> </u>

Table of Contents**3. Deferred Revenue**

Deferred revenue consists of the following (in thousands):

	March 31,	December 31,
	2004	2003
Maintenance and Support	\$ 22,759	\$ 23,346
Other	2,797	2,444
	<u>\$ 25,556</u>	<u>\$ 25,790</u>

Maintenance and support primarily consists of first year maintenance and support services associated with the initial purchase of our software, and the renewal of annual maintenance and support services from customers who purchased our software in prior periods. The maintenance and support period is generally 12 months. Accordingly, maintenance and support revenues are recognized on a straight-line basis over the term of the maintenance and support period.

Other consisted of deferred license, training and consulting fees generated from arrangements, which did not meet some or all of the revenue recognition criteria of SOP 97-2, and are deferred until all revenue recognition criteria have been met.

4. Income Taxes

No income tax provision was recorded in the three months ended March 31, 2004, due to the Company's inability to utilize net operating losses.

5. Geographic Information

Our primary operations are located in the United States. Revenues from international sources related to export sales, primarily to Europe and Asia. Our revenues by geographic area were as follows (in thousands):

	Three Months Ended March 31	
	2004	2003
Revenues:		
North America	\$ 19,519	\$ 21,347
Europe	4,573	3,311
Asia Pacific and others	1,576	472

	<u>\$ 25,668</u>	<u>\$ 25,130</u>
--	------------------	------------------

6. Goodwill and Other Purchased Intangible Assets

Goodwill and intangible assets with indefinite lives consist of the following (in thousands):

	March 31, 2004	December 31 2003
Goodwill	\$ 31,578	\$ 31,578
Accumulated amortization	(10,812)	(10,812)
Goodwill, net	<u>\$ 20,766</u>	<u>\$ 20,766</u>

Table of Contents

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

	March 31, 2004			December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer lists	\$ 10,600	\$ (10,021)	\$ 579	\$ 10,600	\$ (9,896)	\$ 704
Workforce	408	(136)	272	408	(85)	323
Purchased technologies	6,767	(2,989)	3,779	6,767	(2,605)	4,163
Non-compete agreements	1,030	(769)	261	1,030	(707)	323
Trademark	700	(496)	203	700	(453)	246
	<u>\$ 19,505</u>	<u>\$ (14,411)</u>	<u>\$ 5,094</u>	<u>\$ 19,505</u>	<u>\$ (13,746)</u>	<u>\$ 5,759</u>

For the first quarter of fiscal 2004 and 2003, approximately \$384,000 and \$226,000 were associated with the amortization of purchased technologies. The amortization of these costs were classified as cost of license fees in the statements of operations. Amortization of all the intangibles (excluding purchased technologies) were classified as amortization of other intangibles on the statement of operations.

7. Contingencies*MicroStrategy Lawsuit*

In June 2003, the Fairfax County Circuit Court in Fairfax, Virginia, ruled in favor of us and two of our employees on all counts in the trade secret lawsuit filed by MicroStrategy Incorporated (MicroStrategy). In July 2003, MicroStrategy filed a Notice of Leave to Appeal with the Circuit Court and in September 2003 filed a Petition for Appeal with the Virginia State Supreme Court. In March 2004, the Virginia State Supreme Court agreed to hear a portion of MicroStrategy's Petition for Appeal. If the Virginia State Supreme Court overturns, in whole or in part, the Circuit Court's ruling, this could have an adverse impact on our business, operating results and financial condition.

We are also engaged in certain other legal actions arising in the ordinary course of business. Although there can be no assurance as to the outcome of such litigation, we believe we have adequate legal defenses and we believe that the ultimate outcome of any of these actions will not have a material effect on our financial position or results of operations.

Commitments & Contingencies

In November 2002, the FASB released FASB Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others: an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34. FIN 45 establishes new disclosure and liability-recognition requirements for direct and indirect debt guarantees with specified characteristics. The initial measurement and recognition requirements of FIN 45 are effective prospectively for guarantees issued

Edgar Filing: ACTUATE CORP - Form 10-Q

or modified after December 31, 2002. However, the disclosure requirements are effective for interim and annual financial-statement periods ending after December 15, 2002. Our license agreements include an indemnification for the infringement of third party intellectual property rights and also include certain warranties. No amounts have been accrued relating to those indemnities and warranties. As of March 31, 2004, we had also issued letters of credit totaling \$3.9 million related to our leased facilities. We do not have any other guarantees. The adoption of FIN 45 did not have a material impact on our financial position or results of operations.

Table of Contents

8. Subsequent Events

On April 28, 2004, the Board of Directors approved the extension of the Company's stock repurchase program through the second quarter of fiscal 2004. Based on this approval, the Company is now authorized to purchase up to a specific amount of Actuate common stock during this period. Although the purchases have been authorized, it is at the discretion of the Company's officers whether or not any purchases are made and, if so, at what prices.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following information should be read in conjunction with the historical financial information and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2003 as filed with the Securities and Exchange Commission on March 11, 2004.

*The statements contained in this Form 10-Q that are not purely historical are forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, including statements regarding Actuate's expectations, beliefs, hopes, intentions, plans or strategies regarding the future. All forward-looking statements in this Form 10-Q are based upon information available to Actuate as of the date hereof, and Actuate assumes no obligation to update any such forward-looking statements. Actual results could differ materially from Actuate's current expectations. Factors that could cause or contribute to such differences include, but are not limited to, the risks discussed in the section titled *Business Risk Factors* in this Form 10-Q.*

Overview

We are a leading provider of an Enterprise Reporting Application Platform, a unified software platform that enables large organizations and packaged application software vendors to develop and deploy self-service, customer and employee-facing Enterprise Reporting Applications. Enterprise Reporting Applications are intuitive, Web portal-like reporting applications that empower 100% of users with decision-making information. Our Actuate 7 product line provides a platform upon which Global 9000 organizations (companies with annual revenues greater than \$1 billion) and packaged application software vendors develop and deploy mission-critical Enterprise Reporting Applications. These applications retrieve business information from corporate databases and deliver it as interactive Web pages, Excel spreadsheets, and analytic cubes to customers, partners and employees around the globe. Our products and services are used by our customers to develop and deploy Enterprise Reporting Applications across a range of business functions including financial management, sales management, account management, and customer self-service.

We began shipping our first product in January 1996. We sell software products through two primary means: (i) directly to end-user customers through our direct sales force and (ii) through indirect channel partners such as OEMs, resellers and system integrators. OEMs generally integrate our products with their applications and either provide hosting services or resell them with their products. Our other indirect channel partners resell our software products to end-user customers. Our revenues are derived from license fees for software products and fees for services relating to such products, including software maintenance and support, consulting and training.

Our total revenues for the first quarter of fiscal 2004 were \$25.7 million, a 2% increase over the first fiscal quarter of 2003. This modest increase in revenues was primarily attributed to improved sales performance in our overseas locations. For the first quarter of fiscal 2004, net loss was \$377,000 or \$.01 per share, compared with a net loss of \$836,000 or \$.01 per share in the first fiscal quarter of 2003. The smaller loss in the first quarter of 2004 was primarily due to reduced legal expenses associated with the MicroStrategy trial that took place in the first quarter of 2003. Overall headcount has remained relatively stable at 531 heads as of March 31, 2004. We continue to modestly expand our development office in Shanghai, China but overall headcount is not expected to grow significantly in the near term.

Table of Contents

North America total revenues decreased from \$21.3 million in the first quarter of fiscal 2003 to \$19.5 million in the first quarter of fiscal 2004, while revenues from international regions increased by 61% from \$3.8 million in the first quarter of fiscal 2003 to \$6.1 million in the first quarter of fiscal 2004. During the first quarter of fiscal year 2004, we derived 24% of our total revenues from sales outside of North America while 15% of our total revenues were derived from sales outside North America in the first quarter of fiscal year 2003. We anticipate that our ratio of international sales as a percentage of total sales will continue to be significant or grow slightly in the near term.

During fiscal year 2003 and the first quarter of fiscal year 2004, three trends emerged that had a significant impact on our results of operations. First, as an enterprise software vendor, we are impacted by the corporate spending environment for information technology (IT). During 2003, due to weak global economic conditions, we believe that our customers and prospects decreased their spending for IT, which had a negative impact on our business. We currently believe that corporate IT budgets will grow only modestly in 2004. Second, in 2003 we witnessed corporations consolidating their business intelligence software purchases into fewer suppliers. Corporations were reluctant to buy software from new vendors. This impacted our ability to acquire as many new customers as planned. If this trend continues it will impact our business in 2004. Finally, several of our competitors recently released products that are marketed to be directly competitive with our Enterprise Reporting Application Platform. The existence of these competitive products required additional sales and marketing efforts to differentiate our products, which resulted in extended sales cycles. We believe that competition in the enterprise reporting market will be vigorous in 2004.

During the first quarter of 2004, we initiated a change in the way we license our server products. We formerly licensed our server products on a per CPU basis. Under our new licensing model our server products are primarily licensed on a named user basis. Under certain circumstances, existing customers will be able to continue purchasing software under the CPU-based model for existing projects. Under the old CPU-based model, software copies were sold based on how many CPU s the software would be running on. Under the named-user based model, we no longer consider how many CPU s will be running our software. Rather, we now sell the licenses based on how many individual users will be using the product. The licenses are sold in predefined user blocks .

We have a limited ability to forecast future revenues and expenses, thus the prediction of future operating results is difficult and unreliable. In addition, historical growth rates in our revenues and earnings should not be considered indicative of future revenue or earnings growth rates or operating results. There can be no assurance that any of our business strategies will be successful or that we will be able to achieve and maintain profitability on a quarterly or annual basis. It is likely that in some future quarter our operating results will be below the expectations of public market analysts and investors, and in such event the price of our common stock could decline.

Actuate was incorporated in November 1993 in the State of California and reincorporated in the State of Delaware in July 1998. Actuate s principal executive offices are located at 701 Gateway Boulevard, South San Francisco, California. Actuate s telephone number is 650-837-2000. Actuate maintains a Web site at www.actuate.com.

Table of Contents**Results of Operations**

The following table sets forth certain consolidated statement of operations data as a percentage of total revenues for the periods indicated.

	Three Months Ended	
	March 31,	
	2004	2003
	<u> </u>	<u> </u>
Revenues:		
License fees	45%	43%
Services	55	57
	<u> </u>	<u> </u>
Total revenues	100	100
	<u> </u>	<u> </u>
Costs and expenses:		
Cost of license fees	4	2
Cost of services	24	23
Sales and marketing	40	45
Research and development	20	18
General and administrative	11	15
Amortization of other intangibles	1	4
Restructuring charges	2	
	<u> </u>	<u> </u>
Total costs and expenses	102	107
	<u> </u>	<u> </u>
Loss from operations	(2)	(7)
Interest and other income, net	1	1
	<u> </u>	<u> </u>
Loss before income taxes	(1)	(6)
Income tax benefit		(3)
	<u> </u>	<u> </u>
Net loss	(1)%	(3)%
	<u> </u>	<u> </u>

Revenues

Our revenues are derived from license fees and services, which include software maintenance and support, consulting and training. Total revenues increased 2% from \$25.1 million for the quarter ended March 31, 2003 to \$25.7 million for the quarter ended March 31, 2004. Sales outside of North America were \$6.1 million, or 24% of total revenues for the first quarter of fiscal year 2004, compared to \$3.8 million, or 15% of total revenues for the first quarter of fiscal year 2003. No single customer accounted for more than 10% of our revenues for any of the periods presented.

Edgar Filing: ACTUATE CORP - Form 10-Q

License fees. Revenues from license fees increased 6% from \$10.9 million for the first quarter of fiscal year 2003 to \$11.5 million for the first quarter of fiscal year 2004. As a percentage of total revenues, license fee revenues increased from 43% in the first quarter of fiscal year 2003 to 45% in the first quarter of fiscal year 2004. The increase in license fee revenues in absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004, was primarily attributed to improved performance by our overseas locations.

Services. Service revenues decreased 1% from \$14.3 million for the first quarter of fiscal year 2003 to \$14.2 million for the first quarter of fiscal year 2004. As a percentage of total revenues, service revenues decreased from 57% in the first quarter of fiscal year 2003 to 55% in the first quarter of fiscal year 2004.

Table of Contents**Costs and Expenses**

Cost of license fees. Cost of license fees consists primarily of product packaging, documentation, production costs and the amortization of purchased technology. Cost of license fees increased from \$611,000, or 6% of revenues from license fees, for the first quarter of fiscal year 2003 to \$1.1 million, or 10% of revenues from license fees, for the first quarter of fiscal year 2004. The increase in costs of license fees was primarily due to an increase in third party royalties of approximately \$360,000 resulting from the increase in the sales of our analytics product. We expect our cost of license fees as a percentage of revenues from license fees to be between 7% and 10% of revenues from license fees for the remainder of fiscal year 2004.

Cost of services. Cost of services consists primarily of personnel and related costs, facilities costs incurred in providing software maintenance and support, training and consulting services, as well as third-party costs incurred in providing training and consulting services. Cost of services increased from \$5.9 million, or 41% of service revenues, for the first quarter of fiscal year 2003 to \$6.1 million, or 43% of service revenues, for the first quarter of fiscal year 2004. The increase was primarily due to services and support related expenses of approximately \$329,000, due to increased consulting, certified training and support costs in our international locations, offset by a \$129,000 decrease in billable domestic travel and associated costs. We expect our cost of services, as a percentage of services revenues, will be in approximately the same range for the remainder of fiscal year 2004.

Sales and marketing. Sales and marketing expenses consist primarily of salaries, commissions and bonuses earned by sales and marketing personnel, promotional expenses, travel, entertainment and facility costs. Sales and marketing expenses decreased from \$11.2 million, or 45% of total revenues for the first quarter of fiscal year 2003 to \$10.3 million, or 40% of total revenues for the first quarter of fiscal year 2004. The decreases in sales and marketing expenses in both absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004, were primarily due to a decrease of approximately \$259,000 in costs relating to a reduction in sales and marketing personnel by six employees in Europe as well as an approximately \$538,000 decrease in spending on marketing programs. We currently expect our sales and marketing expenses as a percentage of total revenues to be in the range of 40% to 45% of total revenues for the remainder of fiscal year 2004.

Research and development. Research and development expenses are expensed as incurred and consist primarily of personnel and related costs associated with the development of new products, the enhancement of existing products, quality assurance and testing. Research and development expenses increased from \$4.6 million, or 18% of total revenues for the first quarter of fiscal year 2003 to \$5.2 million, or 20% of total revenues for the first quarter of fiscal year 2004. The increases in research and development expenses in both absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004, were primarily due to approximately \$467,000 in additional expenses relating to the addition of engineering personnel and related expenses in connection with the acquisition of Nimble in the third quarter of fiscal 2003. We believe that continued investments in technology and product development are essential for us to remain competitive in the markets we serve, and expect our research and development expenses as a percentage of total revenues to be in the range of 19% to 20% of total revenues for the remainder of fiscal year 2004.

General and administrative. General and administrative expenses consist primarily of personnel and related costs for finance, human resources, information systems and general management, as well as legal, bad debts and accounting expenses. General and administrative expenses decreased from \$3.7 million, or 15% of total revenues for the first quarter of fiscal year 2003 to \$2.7 million, or 11% of total revenues for the first quarter of fiscal year 2004. The decreases in general and administrative expenses in both absolute dollars and as a percentage of total revenues for the three months ended March 31,

Table of Contents

2004, were primarily due to the reduction of costs associated with the MicroStrategy trial for which we incurred \$1.6 million of legal expenses during the three months ended March 31, 2003. The results for the first quarter of fiscal 2004 include approximately \$117,000 of expenses related to our Sarbanes-Oxley Act Section 404 compliance project and training costs associated with the implementation of a new accounting system. We expect our general and administrative expenses as a percentage of total revenues to be about 10% for the remainder of fiscal year 2004.

Amortization of other intangibles. For the three months ended March 31, 2004, we recorded a charge of \$282,000 for the amortization of other intangibles, or 1% of total revenues, as compared to \$770,000 or 4% of total revenues of amortization of other intangibles for the same period of fiscal year 2003. The decreases in amortization of other intangibles in both absolute dollars and as a percentage of total revenues for the three months ended March 31, 2004, were primarily due to the customer base related to prior acquisitions which were fully amortized by the middle of fiscal 2003 resulting in a decrease of \$538,000. These decreases were offset by a \$51,000 increase in amortization of intangibles, namely workforce, associated with the Nimble acquisition in July of last year. The estimated amortizable lives of other intangible assets range between 2 to 5 years and will be fully amortized during fiscal year 2008. We expect the amortization of other intangibles expenses, in absolute dollars, will be in the same range for the remainder of fiscal year 2004.

Restructuring charges. In the first quarter of fiscal 2004, we initiated a restructuring of our French operation consisting primarily of a workforce reduction and associated legal expenses. In connection with this restructuring we recorded a severance charge totaling \$586,000 during this quarter of which \$285,000 was paid during the quarter.

Interest and other income, net. Interest and other income, net, is comprised primarily of interest income earned by us on cash and short-term investments. Interest and other income, net, for the three months ended March 31, 2004 was \$170,000 as compared with \$159,000 for the three months ended March 31, 2003.

Income tax benefit. The interim tax provision for the three months ended March 31, 2004 was computed to be zero due to the Company's inability to utilize net operating losses. The provision for income taxes in fiscal year 2003 was based on the estimated worldwide annual effective income tax rate applied to the pre-tax net loss. The change in provision between the periods presented was primarily due to the non-recognition of the effect of net operating losses in 2004.

Liquidity and Capital Resources

As of March 31, 2004, we had cash, cash equivalents and short-term investments of \$45.9 million, an increase of approximately \$429,000 from \$45.4 million at December 31, 2003; and \$27.6 million in net working capital, an increase of approximately \$490,000 from \$27.1 million at December 31, 2003.

Cash from operating activities. Net cash provided from operating activities was \$230,000 during the three months ended March 31, 2004, compared to \$3.3 million during the three months ended March 31, 2003, a decrease of approximately \$3.1 million. Cash provided by operations is directly related to the generation of revenues and subsequent collection of invoices. For the three-month period ended March 31, 2004, net cash provided by operating activities was generated by the net loss adjusted by non-

Table of Contents

cash items of depreciation and amortization, and increased collections of accounts receivable, that were offset by decreases in deferred revenue and accrued compensation. For the three-month period ended March 31, 2003, net cash provided by operating activities was generated by the net loss adjusted by non-cash items of restructuring charges, depreciation and amortization, increased collections of accounts receivable and increase in income tax payable, that were offset by decreases in deferred revenue and accrued compensation.

Cash from investing activities. Net cash provided by investing activities was \$15.8 million during the three months ended March 31, 2004, compared to net cash used in investing activities of \$3.1 million during the three months ended March 31, 2003, a net increase of \$18.8 million. For the three months ended March 31, 2004, net cash provided by investing activities was primarily due to the proceeds received from the maturity of short-term investments that were offset by the purchases of short-term investments, and purchases of property and equipment. For the three months ended March 31, 2003, net cash used in investing activities was primarily due to purchases of short-term investments, and purchases of property and equipment, that were offset by the proceeds received from the maturity of short-term investments.

Cash from financing activities. Net cash provided by financing activity was \$426,000 during the three months ended March 31, 2004, compared to \$1.3 million during the three months ended March 31, 2003. For the three months ended March 31, 2004, net cash provided by financing activities was from the proceeds derived from issuance of common stock under the stock option plan. For the same period last year, net cash provided by financing activities was primarily from the proceeds derived from the issuance of common stock under the employee stock purchase and stock option plans.

We believe that our current cash balances and any cash generated from operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next twelve months. Thereafter, if cash generated from operations is insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or obtain credit facilities. The sale of additional equity could result in additional dilution to our stockholders. A portion of our cash may be used to repurchase our common stock, acquire or invest in complementary businesses, including the purchase of the remaining interest of our subsidiary in Japan, or products or to obtain the right to use complementary technologies.

Item 4. Controls and Procedures

- (a) *Evaluation of disclosure controls and procedures.* Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable, not absolute, assurance of achieving their control objectives. Subject to these limitations, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2004, our disclosure controls and procedures were effective.
- (b) *Changes in internal controls.* No changes in our internal control over financial reporting occurred during the fiscal quarter ended March 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

RISK FACTORS THAT MAY AFFECT FUTURE RESULTS

Investors should carefully consider the following risk factors and warnings before making an investment decision. The risks described below are not the only ones facing Actuate. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the following risks actually occur, our business, operating results or financial condition could be materially harmed. In such case, the trading price of our common stock could decline and you may lose all or part of your investment. Investors should also refer to the other information set forth in this Report on Form 10-Q, including the financial statements and the notes thereto.

OUR OPERATING RESULTS MAY BE VOLATILE AND DIFFICULT TO PREDICT. IF WE FAIL TO MEET OUR ESTIMATES OF QUARTERLY AND ANNUAL OPERATING RESULTS OR WE FAIL TO MEET THE EXPECTATIONS OF PUBLIC MARKET ANALYSTS AND INVESTORS, THE MARKET PRICE OF OUR STOCK MAY DECREASE SIGNIFICANTLY.

The susceptibility of our operating results to significant fluctuations makes any prediction, including our estimates, of future operating results unreliable. In addition, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and you should not rely on them as indications of our future performance. Our operating results have in the past, and may in the future, vary significantly due to factors such as the following:

- Demand for our products;
- The size and timing of significant orders for our products;
- A slow down or a decrease in spending on information technology by our current and/or Prospective customers;
- The marketing of products by our competitors that are directly competitive with our products;
- The management, performance and expansion of our international operations;
- Customers' desire to consolidate its purchases of business intelligence software to one or a very small number of vendors from which the customer has already purchased software;
- General domestic and international economic and political conditions, including war and terrorism or the threat of war or terrorism;
- Sales cycles and sales performance of our indirect channel partners;
- Changes in the way we price our products;
- The existence and the outcome of the appeal of the MicroStrategy lawsuit;
- Continued successful relationships and the establishment of new relationships with OEMs;
- Changes in our level of operating expenses and our ability to control costs;

Table of Contents

The outcome or publicity surrounding any pending or threatened lawsuits;

Ability to make new products commercially available in a timely manner;

Budgeting cycles of our customers;

Changes in pricing policies by us or our competitors;

Failure to successfully manage acquisitions made by us;

Defects in our products and other product quality problems; and

Failure to successfully meet hiring needs and unexpected personnel changes.

Because our software products are typically shipped shortly after orders are received, total revenues in any quarter are substantially dependent on orders booked and shipped throughout that quarter. Furthermore, several factors may require us, in accordance with accounting principles generally accepted in the United States, to defer recognition of license fee revenue for a significant period of time after entering into a license agreement, including:

Whether the license agreement includes both software products that are then currently available and software products or other enhancements that are still under development;

Whether the license agreement relates entirely or partly to software products that are currently not available;

Whether the license agreement requires the performance of services that may preclude revenue recognition until successful completion of such services; and

Whether the license agreement includes acceptance criteria that may preclude revenue recognition prior to customer acceptance.

In addition, we may in the future experience fluctuations in our gross and operating margins due to changes in the mix of our domestic and international revenues, changes in the mix of our direct sales and indirect sales and changes in the mix of license revenues and service revenues, as well as changes in the mix among the indirect channels through which our products are offered.

A significant portion of our total revenues in any given quarter is derived from existing customers. Our ability to achieve future revenue growth, if any, will be substantially dependent upon our ability to increase revenues from license fees and services from existing customers, to expand our customer base and to increase the average size of our orders. To the extent that such increases do not occur in a timely manner, our business, operating results and financial condition would be harmed.

Edgar Filing: ACTUATE CORP - Form 10-Q

Our expense levels and any plans for expansion, including plans to increase our sales and marketing and research and development efforts, are based in significant part on our expectations of future revenues and are relatively fixed in the short-term. If revenues fall below our expectations and we are unable to quickly reduce our spending in response, our business, operating results and financial condition are likely to be harmed.

Table of Contents

In addition, we have recently changed the way we price our server products, from CPU pricing to named user pricing. At this point, we do not know if the change in pricing methodology will impact our ability to sell our products.

Based upon all of the factors described above, we have a limited ability to forecast future revenues and expenses and it is likely that in some future quarter our operating results will be below our estimates or the expectations of public market analysts and investors. In the event that operating results are below our estimates or other expectations, the price of our common stock could decline.

IF WE FAIL TO GROW REVENUE FROM INTERNATIONAL OPERATIONS AND EXPAND OUR INTERNATIONAL OPERATIONS OUR BUSINESS WOULD BE SERIOUSLY HARMED.

Our total revenues derived from sales outside North America were 24% in the first quarter of 2004 and 15% and 23% in fiscal years 2003 and 2002, respectively. Our ability to achieve revenue growth in the future will depend in large part on our success in increasing revenues from international sales. We intend to continue to invest significant resources to expand our sales and support operations outside North America and to enter additional international markets. In order to expand international sales, we must establish additional foreign operations, expand our international channel management and support organizations, hire additional personnel, recruit additional international resellers and increase the productivity of existing international resellers. If we are not successful in expanding international operations in a timely and cost-effective manner, our business, operating results and financial condition could be harmed.

IF WE DO NOT SUCCESSFULLY EXPAND OUR DISTRIBUTION CHANNELS AND DEVELOP AND MAINTAIN RELATIONSHIPS WITH OEMs, OUR BUSINESS WOULD BE SERIOUSLY HARMED.

To date, we have sold our products principally through our direct sales force, as well as through indirect sales channels, such as our OEMs, resellers and systems integrators. Our revenues from license fees resulting from sales through indirect channel partners were approximately 24% in our first quarter of 2004 and 47% and 32% in fiscal years 2003 and 2002, respectively. Our ability to achieve significant revenue growth in the future will depend in large part on the success of our sales force in further establishing and maintaining relationships with indirect channel partners. In particular, a significant element of our strategy is to embed our technology in products offered by OEMs for resale or as a hosted application to such OEM's customers and end-users. We also intend to establish and expand our relationships with resellers and systems integrators so that such resellers and systems integrators will increasingly recommend our products to their clients. Our future success will depend on the ability of our indirect channel partners to sell and support our products. If the sales and implementation cycles of our indirect channel partners are lengthy or variable or our OEMs experience difficulties embedding our technology into their products or we fail to train the sales and customer support personnel of such indirect channel partners in a timely fashion, our business, operating results and financial condition would be harmed.

Although we are currently investing, and plan to continue to invest, significant resources to expand and develop relationships with OEMs, we have at times experienced and continue to experience difficulty in establishing and maintaining these relationships. If we are unable to successfully expand this distribution channel and secure license agreements with additional OEMs on commercially reasonable terms, including significant up front payments of minimum license fees, and extend existing license agreements with existing OEMs on commercially reasonable terms, our operating results would

Table of Contents

be harmed. Any inability by us to maintain existing or establish new relationships with indirect channel partners, including systems integrators and resellers, or, if such efforts are successful, a failure of our revenues to increase correspondingly with expenses incurred in pursuing such relationships, would harm our business, operating results and financial condition.

WE MAY NOT BE ABLE TO COMPETE SUCCESSFULLY AGAINST CURRENT AND FUTURE COMPETITORS.

Our market is intensely competitive and characterized by rapidly changing technology, evolving standards and recently, new product releases by our competitors that are marketed to compete directly with our products. Our competition comes in four principal forms:

competition from current or future business intelligence software vendors such as Business Objects, Cognos, Hyperion, and MicroStrategy that offer enterprise reporting products;

competition from other large software vendors such as Microsoft, Oracle and SAP, to the extent they include reporting functionality with their applications or databases;

competition from other software vendors and software development tool vendors; and

competition from the IT departments of current or potential customers that may develop scalable Enterprise Reporting Applications internally which may be cheaper and more customized than our products.

Most of our current and potential competitors have significantly greater financial, technical, marketing and other resources than us. These competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements or devote greater resources to the development, promotion and sales of their products than we may. Also, most current and potential competitors have greater name recognition and the ability to leverage a significant installed customer base. These companies have released and can continue to release competing enterprise reporting software products or significantly increase the functionality of their existing reporting software products, either of which would result in a loss of market share for us. We expect additional competition as other established and emerging companies enter the Enterprise Reporting Application market and new products and technologies are introduced. Increased competition could result in price reductions, fewer customer orders, reduced gross margins, longer sales cycles and loss of market share, any of which would harm our business, operating results and financial condition.

Current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties, thereby increasing their ability to address the needs of our prospective customers. Also our current or future channel partners may have established in the past, or may in the future, establish cooperative relationships with our current or potential competitors, thereby limiting our ability to sell our products through particular distribution channels. It is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. Such competition could harm our ability to obtain revenues from license fees and services from new or existing customers on terms favorable to us. If we are unable to compete successfully against current and future competitors our business, operating results and financial condition would be harmed.

Table of Contents

INTELLECTUAL PROPERTY CLAIMS AGAINST US CAN BE COSTLY AND COULD RESULT IN THE LOSS OF SIGNIFICANT RIGHTS.

Third parties may claim that our current or future products infringe such parties' intellectual property rights. We expect companies in the Business Intelligence software market will increasingly be subject to infringement claims as the number of products and/or competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any such claims, with or without merit, could be time-consuming to defend, result in costly litigation, divert management's attention and resources, cause product shipment delays or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all. A successful claim of product infringement against us and our failure or inability to license the infringed or similar technology could harm our business, operating results and financial condition.

IF THE MARKET FOR ENTERPRISE REPORTING APPLICATION SOFTWARE DOES NOT GROW AS WE EXPECT, OUR BUSINESS WOULD BE SERIOUSLY HARMED.

The market for Enterprise Reporting Application software products is still emerging and we cannot be certain that it will continue to grow or that, even if the market does grow, businesses will purchase our products. If the market for Enterprise Reporting Application software products fails to grow or grows more slowly than we expect, our business, operating results and financial condition would be harmed. To date, all of our revenues have been derived from licenses for our enterprise reporting software and related products and services, and we expect this to continue for the foreseeable future. We have spent, and intend to continue to spend, considerable resources educating potential customers and indirect channel partners about Enterprise Reporting Applications and our products. However, if such expenditures do not enable our products to achieve any significant degree of market acceptance, our business, operating results and financial condition would be harmed.

BECAUSE THE SALES CYCLES OF OUR PRODUCTS ARE LENGTHY AND VARIABLE, OUR QUARTERLY RESULTS MAY FLUCTUATE.

The purchase of our products by our end-user customers for deployment within the customer's organization typically involves a significant commitment of capital and other resources, and is therefore subject to delays that are beyond our control. These delays can arise from a customer's internal procedures to approve large capital expenditures, budgetary constraints and the testing and acceptance of new technologies that affect key operations as well as general economic and political events. The sales cycle for initial orders and larger follow-on orders for our products can be lengthy and variable. Recently, we have been experiencing longer sales cycle. Additionally, sales cycles for sales of our products to OEMs tend to be longer, ranging from 6 to 24 months or more and may involve convincing the vendor's entire organization that our products are the appropriate software for the vendor's application. This time period does not include the sales and implementation cycles of such vendor's own products, which can be longer than our sales and implementation cycles. Certain of our customers have in the past, or may in the future, experience difficulty completing the initial implementation of our products. Any difficulties or delays in the initial implementation by our end-user customers or our indirect channel partners could cause such customers to reject our software or lead to the delay or non-receipt of future orders for the large-scale deployment of our products.

WE MAY MAKE FUTURE ACQUISITIONS AND ACQUISITIONS INVOLVE NUMEROUS RISKS

Our business is highly competitive, and as such, our growth is dependent upon market growth and our ability to enhance our existing products, introduce new products on a timely basis and expand our distribution channels and professional services organization. One of the ways we have addressed and

Table of Contents

will continue to address these issues is through acquisitions of other companies. Acquisitions involve numerous risks, including the following:

Difficulties in integration of the operations, technologies, and products of the acquired companies;

The risk of diverting management's attention from normal daily operations of the business;

Negative impact to our financial condition and results of operations resulting from combining the acquired company's financial condition and results of operations with our financial statements;

Risks of entering markets in which we have no or limited direct prior experience; and

The potential loss of key employees of the acquired company.

Mergers and acquisitions of high-technology companies are inherently risky, and we cannot assure you that any acquisition will be successful and will not materially harm our business, operating results or financial condition.

IF WE DO NOT RESPOND TO RAPID TECHNOLOGICAL CHANGES, OUR PRODUCTS COULD BECOME OBSOLETE AND OUR BUSINESS COULD BE SERIOUSLY HARMED.

The market for our products is characterized by rapid technological changes, frequent new product introductions and enhancements, changing customer demands and evolving industry standards. Any of these factors can render existing products obsolete and unmarketable. We believe that our future success will depend in large part on our ability to support current and future releases of popular operating systems and computer programming languages, databases and software applications, to timely develop new products that achieve market acceptance and to meet an expanding range of customer requirements. If the announcement or introduction of new products by us or our competitors or any change in industry standards causes customers to defer or cancel purchases of existing products, our business, operating results and financial condition would be harmed. As a result of the complexities inherent in Enterprise Reporting Applications, major new products and product enhancements can require long development and testing periods. In addition, customers may delay their purchasing decisions in anticipation of the general availability of new or enhanced versions of our products. As a result, significant delays in the general availability of such new releases or significant problems in the installation or implementation of such new releases could harm our business, operating results and financial condition. If we fail to successfully develop, on a timely and cost effective basis, product enhancements or new products that respond to technological change, evolving industry standards or customer requirements or such new products and product enhancements fail to achieve market acceptance, our business, operating results and financial condition may be harmed.

IF WE DO NOT RELEASE NEW PRODUCTS AND ENHANCEMENTS TO EXISTING PRODUCTS IN A TIMELY MANNER OR IF SUCH NEW PRODUCTS AND ENHANCEMENTS FAIL TO ACHIEVE MARKET ACCEPTANCE, OUR BUSINESS COULD BE SERIOUSLY HARMED.

We believe that our future success will depend in large part on the success of new products and enhancements to our products that we make generally available. Prior to the release of any new products or enhancements, the products must undergo a long development and testing period. To date, the development and testing of new products and enhancements have taken longer than expected. In the event the development and testing of new products and enhancements continue to take longer than expected, the release of new products and enhancements will be delayed.

If we fail to release new

Table of Contents

products and enhancements in a timely manner, our business, operating results and financial condition may be harmed. In addition, if such new products and enhancements do not achieve market acceptance our business, operating results and financial condition may be harmed.

THERE ARE MANAGEMENT AND OPERATIONAL RISKS ASSOCIATED WITH OUR INTERNATIONAL OPERATIONS THAT COULD SERIOUSLY HARM OUR BUSINESS.

A substantial portion of Actuate's revenues is derived from international sales. International operations are subject to a number of risks, any of which could harm our business, operating results and financial conditions. These risks include the following:

Economic and political instability, including war and terrorism or the threat of war and terrorism;

Difficulty in managing an organization spread across many countries;

Multiple and conflicting tax laws and regulations;

Costs of localizing products for foreign countries;

Difficulty in hiring employees in foreign countries;

Trade laws and business practices favoring local competition;

Dependence on local vendors;

Compliance with multiple, conflicting and changing government laws and regulations;

Longer sales cycles;

Import and export restrictions and tariffs;

Difficulties in staffing and managing foreign operations;

Greater difficulty or delay in accounts receivable collection; and

Foreign currency exchange rate fluctuations.

We believe that, over time, an increasing portion of our revenues and costs will be denominated in foreign currencies. To the extent such denomination in foreign currencies does occur, gains and losses on the conversion to U.S. dollars of accounts receivable, accounts payable and

Edgar Filing: ACTUATE CORP - Form 10-Q

other monetary assets and liabilities arising from international operations may contribute to fluctuations in our results of operations. Although we may from time to time undertake foreign exchange hedging transactions to cover a portion of our foreign currency transaction exposure, we currently do not attempt to cover any foreign currency exposure. If we are not successful in any future foreign exchange hedging transactions that we engage in, our business, operating results and financial condition could be harmed.

Table of Contents

IF MICROSTRATEGY'S APPEAL IS SUCCESSFUL, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION

In June 2003, the Fairfax County Circuit Court in Fairfax, Virginia, ruled in favor of us and two of our employees on all counts in the trade secret lawsuit filed by MicroStrategy Incorporated. In July 2003, MicroStrategy filed a Notice of Leave to Appeal with the Circuit Court and in September 2003, MicroStrategy filed a Petition for Appeal with the Virginia State Supreme Court. In March 2004, the Virginia State Supreme Court agreed to hear a portion of MicroStrategy's Petition for Appeal. If the Virginia State Supreme Court agrees to hear MicroStrategy's appeal and if the Virginia State Supreme Court overturns, in whole or in part, the Circuit Court's ruling, this could have an adverse impact on our business, operating results and financial condition and result in the following:

We could be forced to stop selling our products;

We could incur substantial legal costs;

We may be required to indemnify our customers;

We may have to use significant engineering resources to redesign our products;

We may be required to enter into a licensing agreement with MicroStrategy containing terms that are unfavorable to us; and

Our customer's decision to purchase our products and services could be negatively impacted.

TO MANAGE OUR BUSINESS, WE NEED TO IMPROVE AND IMPLEMENT OUR INTERNAL SYSTEMS, PROCEDURES AND CONTROLS. IF WE ARE UNABLE TO DO SO SUCCESSFULLY, OUR BUSINESS WOULD BE SERIOUSLY HARMED.

In 2004, we intend to implement a new financial accounting software system. Also during 2004, we must document, test and as appropriate modify our internal controls and procedures to comply with section 404 of the Sarbanes-Oxley Act. These projects will put a significant strain on our management, information systems and resources. Failure to successfully complete both of these projects in a timely fashion could have a significant adverse effect on our business.

We believe the scope of our operations has placed and will continue to place a significant strain on our management, information systems and resources. Any acquisitions made by us will also put a significant strain on our management, information systems and resources. In addition, we expect that an expansion of our international operations will lead to increased financial and administrative demands associated with managing our international operations and managing an increasing number of relationships with foreign partners and customers and expanded treasury functions to manage foreign currency risks. If we fail to manage our business effectively, our business, operating results and financial condition would be harmed.

OUR EXECUTIVE OFFICERS AND CERTAIN KEY PERSONNEL ARE CRITICAL TO OUR BUSINESS AND THESE OFFICERS AND KEY PERSONNEL MAY NOT REMAIN WITH US IN THE FUTURE.

Our future success depends upon the continued service of our executive officers and other key engineering, sales, marketing and customer support personnel. None of our officers or key employees is bound by an employment agreement for any specific term. If we lose the service of one or more of our key employees, or if one or more of our executive officers or key employees decide to join a competitor or otherwise compete directly or indirectly with us, this could have a significant adverse effect on our business.

Table of Contents

IF OUR PRODUCT CONTAINS MATERIAL DEFECTS, OUR BUSINESS COULD BE SERIOUSLY HARMED.

Software products as complex as those offered by us often contain errors or defects, particularly when first introduced, when new versions or enhancements are released and when configured to individual customer computing systems. We currently have known errors and defects in our products. Despite testing conducted by us, if additional defects and errors are found in current versions, new versions or enhancements of our products after commencement of commercial shipment, this could result in the loss of revenues or a delay in market acceptance. The occurrence of any of these events could seriously harm our business, operating results and financial condition.

IF A SUCCESSFUL PRODUCT LIABILITY CLAIM IS MADE AGAINST US, OUR BUSINESS WOULD BE SERIOUSLY HARMED.

Although license agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims, it is possible that such limitation of liability provisions may not be effective as a result of existing or future laws or unfavorable judicial decisions. The sale and support of our products may entail the risk of such claims, which are likely to be substantial in light of the use of our products in business-critical applications. A product liability claim brought against us could seriously harm our business, operating results and financial condition.

IF THE PROTECTION OF OUR PROPRIETARY RIGHTS IS INADEQUATE, OUR BUSINESS COULD BE SERIOUSLY HARMED.

We have a small number of issued and pending U.S. patents and we rely primarily on a combination of copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary technology. For example, we license our software pursuant to shrink-wrap or signed license agreements, which impose certain restrictions on licensees' ability to utilize the software. In addition, we seek to avoid disclosure of our intellectual property, including requiring those persons with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code. We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult, and while we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of many countries do not protect our proprietary rights to as great an extent as do the laws of the United States. If our means of protecting our proprietary rights is not adequate or our competitors independently develop similar technology, our business could be seriously harmed.

OUR COMMON STOCK PRICE MAY BE VOLATILE, WHICH COULD RESULT IN SUBSTANTIAL LOSSES FOR STOCKHOLDERS.

The market price of shares of our common stock has been and is likely to continue to be highly volatile and may be significantly affected by factors such as the following:

Actual or anticipated fluctuations in our operating results;

Table of Contents

Changes in the economic and political conditions in the United States and abroad;

Terrorist attacks, war or the threat of war;

The announcement of mergers or acquisitions by us or our competitors;

Developments in ongoing or threatened litigation;

Announcements of technological innovations;

New products or new contracts announced by us or our competitors;

Developments with respect to copyrights or proprietary rights;

Price and volume fluctuations in the stock market;

Changes in corporate purchasing of Enterprise Reporting Application software;

Failure to comply with section 404 of the Sarbanes-Oxley Act by December 31, 2004 ;

Adoption of new accounting standards affecting the software industry; and

Changes in financial estimates by securities analysts.

In addition, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against such company. If we are involved in such litigation, it could result in substantial costs and a diversion of management's attention and resources and could harm our business, operating results and financial condition.

CHANGES IN TAX RATES OR NEGATIVE TAX RULINGS COULD ADVERSELY IMPACT OUR FINANCIAL RESULTS

We are taxable principally in the United States and certain jurisdictions in Europe and Asia/Pacific. All of these jurisdictions have in the past and may in the future make changes to their corporate income tax rates and other income tax laws, which could increase our future income tax provision. While we believe that all material income tax liabilities are reflected properly in our balance sheet, we have no assurance that we will prevail in all cases in the event the taxing authorities disagree with our interpretations of the tax law. Future levels of research and development spending will impact our entitlement to related tax credits, which generally lower our effective income tax rate. Future effective income tax rates could be adversely affected if earnings are lower than anticipated in jurisdictions where we have statutory tax rates lower than in the United States.

CERTAIN OF OUR CHARTER PROVISIONS AND DELAWARE LAW, MAY PREVENT OR DETER A CHANGE IN CONTROL OF ACTUATE.

Actuate's Certificate of Incorporation, as amended and restated (the "Certificate of Incorporation"), and Bylaws, as amended and restated ("Bylaws"), contain certain provisions that may have the effect of discouraging, delaying or preventing a change in control of Actuate or unsolicited acquisition proposals that a stockholder might consider favorable, including provisions authorizing the issuance of "blank check" preferred stock and eliminating the ability of stockholders to act by written consent. In addition, certain provisions of Delaware law and our stock option plans may also have the effect of discouraging, delaying or preventing a change in control or unsolicited acquisition proposals. The anti-takeover effect of these provisions may also have an adverse effect on the public trading price of our common stock.

Table of Contents

Part II. Other Information

Item 1. Legal Proceedings

MicroStrategy Lawsuit

In June 2003, the Fairfax County Circuit Court in Fairfax, Virginia, ruled in favor of us and two of our employees on all counts in the trade secret lawsuit filed by MicroStrategy Incorporated ("MicroStrategy"). In July 2003, MicroStrategy filed a Notice of Leave to Appeal with the Circuit Court and in September 2003, MicroStrategy filed a Petition for Appeal with the Virginia State Supreme Court. In March 2004, the Virginia State Supreme Court agreed to hear a portion of MicroStrategy's Petition for Appeal. If the Virginia State Supreme Court overturns, in whole or in part, the Circuit Court's ruling, this could have an adverse impact on our business, operating results and financial condition.

We are also engaged in certain other legal actions arising in the ordinary course of business. Although there can be no assurance as to the outcome of such litigation, we believe we have adequate legal defenses and we believe that the ultimate outcome of any of these actions will not have a material effect on our financial position or results of operations.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer

32 Section 1350 Certifications

(b) Reports on Form 8-K:

Report Date	Description of Document
January 21, 2004	The Company furnished a Current Report on Form 8-K to report, under Item 9 thereof, the issuance of a press release announcing that the Securities and Exchange Commission has terminated its investigation regarding two software license transactions that the company executed with Unify Corporation in early 2000, and has recommended that no enforcement action be taken against either Actuate Corporation or Nico Nierenberg.
January 29, 2004	The Company furnished a Current Report on Form 8-K to report, under Item 12 thereof, the issuance of a press release regarding the Company's financial results for the quarter and year ended December 31, 2003.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Actuate Corporation

(Registrant)

Dated: May 6, 2004

By: /s/ DANIEL A. GAUDREAU

Daniel A. Gaudreau

Senior Vice President, Finance and Administration and
Chief Financial Officer (Principal Financial and Accounting
Officer)