ACTUATE CORP
Form 10-Q
August 09, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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	**94-3193197**
(State of incorporation)	**(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 x No ¨

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

Yes x No ¨

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

Title of Class	Outstanding as of June 30, 2004
Common Stock, par value $.001 per share	**61,706,913**

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Part I. Financial Information

Item 1. Financial Statements

ACTUATE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	June 30, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 24,303	$ 8,950
Short-term investments	26,019	36,489
Accounts receivable, net of allowances of $1,246 at June 30, 2004 and $2,277 at December 31, 2003	19,445	20,208
Other current assets	2,510	2,599
Total current assets	72,277	68,246
Property and equipment, net	5,530	5,097
Goodwill, net	20,766	20,766
Other intangibles, net	4,435	5,759
Other assets	1,180	1,538
	$ 104,188	$ 101,406
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,510	$ 2,758
Current portion of restructuring liabilities	2,504	2,198
Accrued compensation	4,139	4,402
Other accrued liabilities	5,085	4,772
Income taxes payable	1,964	1,241
Deferred revenue	26,749	25,790
Total current liabilities	43,951	41,161
Restructuring liabilities, net of current portion	13,976	15,064
Stockholders equity	46,261	45,181
	$ 104,188	$ 101,406

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

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ACTUATE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
Revenues:				
License fees	$ 12,296	$ 11,898	$ 23,773	$ 22,754
Services	15,553	14,108	29,744	28,382
Total revenues	27,849	26,006	53,517	51,136
Costs and expenses:				
Cost of license fees	831	621	1,931	1,232
Cost of services	6,580	5,853	12,669	11,756
Sales and marketing	10,706	11,534	21,000	22,722
Research and development	5,224	4,398	10,415	8,967
General and administrative	2,373	3,108	5,046	6,850
Amortization of other purchased intangibles	276	700	558	1,470
Restructuring charges			586	
Total costs and expenses	25,990	26,214	52,205	52,997
Income (loss) from operations	1,859	(208)	1,312	(1,861)
Interest and other income, net	214	141	384	300
Income (loss) before income taxes	2,073	(67)	1,696	(1,561)
Provision for income taxes	778	1,794	778	1,136
Net income (loss)	$ 1,295	$ (1,861)	$ 918	$ (2,697)
Basic net income (loss) per share	$ 0.02	$ (0.03)	$ 0.01	$ (0.04)
Shares used in basic per share calculation	61,488	60,404	61,423	60,316
Diluted net income (loss) per share	$ 0.02	$ (0.03)	$ 0.01	$ (0.04)
Shares used in diluted per share calculation .	65,623	60,404	65,366	60,316

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

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ACTUATE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Six Months Ended June 30,	
	2004	**2003**
Operating activities		
Net income (loss)	$ 918	$ (2,697)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Amortization of deferred compensation		41
Amortization of purchased intangibles	1,324	1,921
Depreciation	1,225	1,677
Changes in operating assets and liabilities:		
Accounts receivable .	763	4,368
Other current assets	89	732
Deferred tax assets		146
Accounts payable	752	424
Accrued compensation	(263)	127
Other accrued liabilities	313	(535)
Income taxes payable	723	145
Restructuring liabilities	(782)	(2,069)
Deferred revenue	959	(223)
Net cash provided by operating activities	6,021	4,057
Investing activities		
Purchases of property and equipment	(1,658)	(1,138)
Proceeds from maturity of short-term investments	35,469	30,192
Purchases of short-term investments	(25,080)	(16,417)
Net change in other assets	358	(175)
Net cash provided by investing activities	9,089	12,462
Financing activities		
Proceeds from issuance of common stock	1,334	1,819
Stock repurchases	(1,179)	(1,015)
Net cash provided by financing activities	155	804
Net increase in cash and cash equivalents	15,265	17,323
Effect of exchange rate change on cash	88	(30)
Cash and cash equivalents at the beginning of the period	8,950	23,595
Cash and cash equivalents at the end of the period	$ 24,303	$ 40,888

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

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. 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 six months ended June 30, 2004 are not necessarily indicative of operating results for any other future interim period or 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). 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 unusual 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 met.

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 U.S. resellers and distributors when there is persuasive evidence of an arrangement with the reseller or distributor, the product has been shipped, the

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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. In some instances there is a timing difference between when our reseller completes its sale to the end-user and the period in which we receive the documentation required for revenue recognition. Because we delay revenue recognition until the required documentation is obtained, we may recognize revenue in a period subsequent to the period in which the reseller completes the sale to its end-user.

We also enter into OEM arrangements that provide for license fees based on 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 United States OEM arrangements when a license agreement has been signed by both parties, the product has been shipped, there are no unusual 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. For sales through international OEMs, we defer revenue until we receive a royalty report from such OEM assuming all other revenue recognition criteria have been met. As discussed above, there may be a timing difference between the period in which our OEM completes the sale to its end-user, and the period in which we recognize the revenue.

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 when all other revenue recognition criteria are met, provided services do not include significant customization or modification of the 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, Accounting for Stock-Based Compensation as amended by SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure and continue to account for employee 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. Stock option grants to non-employees are accounted for using the fair value method under SFAS 123.

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The fair value of the options granted under our Stock Option Plans and stock issued under our Employee Stock Purchase Plan in all periods was estimated using the Black-Scholes method, with the following weighted-average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
Dividend yield	0.00%	0.00%	0.00%	0.00%
Risk-free interest rate	3.13%	2.46%	3.13%	2.62%
Expected volatility	109.58%	116.09%	109.58%	114.27%
Expected life of grants under the Stock Option Plans	3 years	3 years	3 years	3 years
Expected life of grants under the Purchase Plan	0.5 year	0.5 year	0.5 year	0.5 year

The following table illustrates the effect on net income (loss) and net income (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 June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
Net income (loss) - as reported	$ 1,295	$ (1,861)	$ 918	$ (2,697)
Add: Stock-based employee compensation expense, included in the determination of net income (loss) as reported, net of tax		12		38
Less: Stock-based employee compensation expense determined under the fair value method for all awards, net of tax	(2,063)	(4,296)	(4,380)	(10,775)
Net loss- pro forma	$ (768)	$ (6,145)	$ (3,462)	$ (13,434)
Net income (loss) per share - basic:				
As reported	$ 0.02	$ (0.03)	$ 0.01	$ (0.04)
Pro forma under SFAS 148	$ (.01)	$ (0.10)	$ (0.06)	$ (0.22)
Net income (loss) per share diluted:				
As reported	$ 0.02	$ (0.03)	$ 0.01	$ 0.04
Pro forma under SFAS 148	$ (.01)	$ (0.10)	$ (0.06)	$ (0.22)

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 Income (Loss) Per Share

Basic net income (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income (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).

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Numerator:				
Net income (loss)	$ 1,295	$ (1,861)	$ 918	$ (2,697)
Denominator:				
Weighted-average common shares outstanding	61,488	60,404	61,423	60,316
Weighted-average employee stock options outstanding	4,135		3,943	
Denominator for basic and diluted net income (loss) per share	65,623	60,404	65,366	60,316
Basic and diluted net income (loss) per share	$ 0.02	$ (0.03)	$ 0.01	$ (0.04)

All outstanding stock options and shares subject to repurchase have been excluded from the calculation of diluted net loss per share in the three and six months ended June 30, 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 19,961,000 in the three months ended June 30, 2003 and 22,348,000 in the six months ended June 30, 2003. 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.

We generated net income for the three and six month periods ending June 30, 2004. Under the treasury stock method, stock options with exercise prices exceeding the average share price of the Company s common stock during the applicable period are excluded from the diluted earnings per share computation. The weighted-average number of common shares excluded from the calculation of diluted net income was 7,715,644 in the three months ended June 30, 2004 and 8,100,147 in the six months ended June 30, 2004.

Comprehensive Income (Loss)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003

Net income (loss)	$ 1,295	$ (1,861)	$918	$ (2,697)
Foreign currency translation adjustment, net of tax effect	129	1	55	(16)
Unrealized loss on available-for-sale-securities, net of tax effect	(50)	(4)	(50)	(8)
Comprehensive income (loss)	$ 1,374	$ (1,864)	$923	$ (2,721)

The net tax effect on foreign currency translation and unrealized loss on short-term investments is $48,000 and $2,000 for the three and six months ending June 30, 2004, respectively. For the same period last year, the net tax effect on foreign currency translation and unrealized loss on short-term investments was zero and $14,000, respectively.

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.

Recent Accounting Pronouncements

In November 2003, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain investments* (EITF 03-1), which addresses how to determine the meaning of other-than temporary for impairments and how that concept should be applied to investments accounted for as either available-for-sale or held-to-maturity under SFAS 115 or in accordance with SFAS 124. The recognition and measurement provisions of EITF 03-1 are applicable for reporting periods beginning after June 15, 2004. Disclosures are effective in annual financial statements for fiscal years ending after December 15, 2003. The adoption of EITF 03-1 did not have a material effect on our operating results or financial condition.

2. Restructuring Charges

In the third quarter of fiscal year 2002, in response to the deteriorating global economic conditions, we implemented a restructuring plan which included a facility exit plan. 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 fiscal year 2002. As of June 30, 2004, $16.2 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 June 30, 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).

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 people 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 six months ended June 30, 2004 (in thousands):

	Severance & Benefits	Facility Related	Total
Total accrual balance December 31, 2003	$	$ 17,262	$ 17,262
Accrual adjustments	586		586
Cash payments, net	(315)	(1,053)	(1,368)
Total accrual balance June 30, 2004	271	16,209	16,480

Less: current portion	(271)	(2,233)	(2,504)
Long-term portion June 30, 2004	$	$ 13,976	$ 13,976

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3. Deferred Revenue

Deferred revenue consists of the following (in thousands):

	June 30, 2004	December 31, 2003
Maintenance and support	$24,381	$23,346
Other	2,368	2,444
	$26,749	$25,790

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 that 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

The interim tax provisions for the three months and six months ended June 30, 2004 and 2003 consists primarily of U.S. and state taxes on domestic operations, and are computed based on the annual estimated effective rates applicable to such operations.

5. Geographic Information

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues:				
North America	$ 22,344	$ 21,780	$ 41,864	$ 43,127
Europe	4,176	3,384	8,749	6,695

Asia Pacific and others	1,329	842	2,904	1,314
	$ 27,849	$ 26,006	$ 53,517	$ 51,136

As of June 30, 2004, we operated solely in one segment, which is the development, marketing and support of the Actuate Enterprise Reporting Application Platform. The Company had one customer that accounted for approximately 10% of the Company s total revenue for the three months ended June 30, 2004. There were no customers that accounted for more than 10% of total revenues in the first quarter of 2004 or the first six months of fiscal year 2003.

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6. Goodwill and Other Purchased Intangible Assets

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

	June 30, 2004	December 31, 2003
Goodwill	$ 31,578	$ 31,578
Accumulated amortization prior to January 1, 2002	(10,812)	(10,812)
Goodwill, net	$ 20,766	$ 20,766

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

	June 30, 2004			December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer lists	$ 10,600	$ (10,146)	$ 454	$ 10,600	$ (9,896)	$ 704
Workforce	408	(187)	221	408	(85)	323
Purchased technologies	6,767	(3,371)	3,396	6,767	(2,605)	4,163
Non-compete agreements	1,030	(825)	205	1,030	(707)	323
Trademark	700	(541)	159	700	(453)	246
	$ 19,505	$ (15,070)	$ 4,435	$ 19,505	$ (13,746)	$ 5,759

For the second quarter of fiscal 2004 and 2003, amortization expense associated with the amortization of purchased technologies was approximately $383,000 and $226,000, respectively. For the six months ended June 30, 2004 and 2003, amortization expense associated with the amortization of purchased technologies was approximately $766,000 and $451,000, respectively. The amortization of these purchased technologies costs is classified as cost of license fees in the condensed consolidated statements of operations. Amortization of all other intangibles (excluding purchased technologies) is classified as amortization of other purchased intangibles on the condensed consolidated statements 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 and such appeal was heard in June 2004. A ruling is expected in September, 2004. 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.

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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

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 June 30, 2004, we had also issued letters of credit totaling $3.9 million related to our leased facilities. We do not have any other guarantees.

Operating Lease Commitments

Actuate leases its headquarter facilities under non-cancelable operating leases expiring in April 2011. In conjunction with the signing of these building leases, we provided the landlord with a letter of credit in the amount of $3.9 million as a security deposit. We have granted security interest in all of our assets as a security for the letter of credit. As of June 30, 2004, aggregate minimum lease commitments under all operating leases are as follows (in thousands):

Fiscal Year	**Future minimum lease payment**	**Future sublease proceeds**	**Net future minimum lease payments**
2004	$ 3,165	$ (620)	$ 2,545
2005	6,341	(1,267)	5,074
2006	5,886	(212)	5,674
2007	5,958		5,958
2008	3,872		3,872
Thereafter	8,505		8,505
	$ 33,727	$ (2,099)	$ 31,628

8. Subsequent Events

On July 28, 2004, the Board of Directors approved an on-going extension of the Company s stock repurchase program. We are now authorized to repurchase up to $1.5 million of Actuate common stock on a quarterly basis. Although the repurchase of Actuate common stock has been authorized, it is at the discretion of the Company s officers whether or not any purchases are made and, if so, at what price.

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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 and 8 product lines provide 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 second quarter of fiscal 2004 were $27.8 million, a 7% increase over the second fiscal quarter of 2003. The increase in revenues was primarily attributed to improved international sales which grew over 30%, or $1.3 million, and an overall growth in services which grew by 10%, or $1.4 million, versus the same period last year. For the second quarter of fiscal 2004, net income was $1.3 million or $.02 per share, compared with a net loss of $1.9 million or $.03 per share in the second fiscal quarter of 2003. The income in the second quarter of 2004 was primarily due to the increase in sales and an overall net reduction in expenses resulting from reduced legal expenses associated with the MicroStrategy trial that took place in the first quarter of 2003. Our total headcount was 544 heads as of June 30, 2004, a 4% increase from the same period in the prior year. Most of this increase occurred in our research and development group due to our acquisition of Nimble Technologies

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in the third quarter of last year and the expansion of our operations in Shanghai, China. This growth was offset by reductions in our indirect and international sales staff. We expect to continue to modestly expand our development office in Shanghai, China but our total headcount is not expected to grow significantly in the near term.

North America total revenues increased from $21.8 million in the second quarter of fiscal 2003 to $22.4 million in the second quarter of fiscal 2004. Revenues from international regions also increased from $4.2 million in the second quarter of fiscal 2003 to $5.5 million in the second quarter of fiscal 2004. During the second quarter of fiscal year 2004, we derived 20% of our total revenues from sales outside of North America versus 16% in the same period last year. We anticipate that international sales as a percentage of total sales will continue to increase slightly in the near term.

During the first half of fiscal year 2004, the following trends had a significant impact on our results of operations. First, we experienced a weak corporate spending environment for information technology . Second we continued to see corporations consolidating their business intelligence software purchases into fewer suppliers. This impacted our ability to acquire as many new Global 9000 customers as planned. Finally, we continue to experience vigorous competition in the enterprise reporting market. We believe that these trends will continue during the remainder of 2004.

During the first half of 2004, we introduced an additional way in which we license our server products. This change was made to allow for a lower entry point for new customers as well as to address the increases in the performance of individual CPU s and the scalability of our software. We formerly only licensed our server products on a CPU basis. Under our new licensing model our server products can either be licensed on a CPU basis or on a named user basis. Under the CPU based model, software copies are licensed based on how many CPU s are contained in the server or cluster of servers on which our server software is installed. Under the named user based model, we license our software based on how many individual users will be receiving content generated by our software. These nam