

BITSTREAM INC
Form 10-Q
November 13, 2001

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 September 30, 2001

or

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

For the transition period from ____ to ____

COMMISSION FILE NUMBER: 0-21541

BITSTREAM INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

04-2744890

(I.R.S. Employer Identification No.)

215 First Street Cambridge, Massachusetts

(Address of principal executive offices)

02142

(Zip Code)

(617) 497-6222

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

On November 9, 2001 there were 8,277,628 shares of Class A Common Stock, par value \$0.01 per share, and no shares of Class B Common Stock, par value \$0.01 per share, outstanding.

BITSTREAM INC. AND SUBSIDIARIES

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PART 1, ITEM 1. FINANCIAL STATEMENTS**BITSTREAM INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS****(In thousands)****(Unaudited)**

| | September 30, 2001 | December 31, 2000 |
|--|-------------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 6,003 | \$ 7,149 |
| Accounts receivable, net of allowance of \$177 and \$663 at September 30, 2001 and December 31, 2000, respectively | 1,068 | 2,043 |
| Prepaid expenses and other current assets | 71 | 198 |
| Total current assets | 7,142 | 9,390 |
| Property and equipment, net | 536 | 636 |
| Other assets: | | |
| Restricted cash | 300 | 300 |
| Goodwill, net of amortization of \$1,501 and \$1,149 at September 30, 2001 and December 31, 2000, respectively | 844 | 1,196 |
| Investment in DiamondSoft, Inc. | 480 | 449 |
| Other | 243 | 136 |
| Total other assets | 1,867 | 2,081 |
| Total assets | \$ 9,545 | \$ 12,107 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 342 | \$ 261 |
| Accrued expenses | 1,236 | 1,287 |
| Deferred revenue | 663 | 471 |
| Total current liabilities | 2,241 | 2,019 |
| Long-term deferred revenue | 11 | 39 |

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| | | |
|--|-----------|-----------|
| Total liabilities | 2,252 | 2,058 |
| Stockholders' equity : | | |
| Common stock, \$.01 par value: Authorized - 30,500 shares. Issued: 8,265 and 7,903 at September 30, 2001 and December 31, 2000, respectively | 83 | 79 |
| Additional paid-in capital | 32,192 | 31,960 |
| Accumulated deficit | (24,622) | (21,630) |
| Treasury stock, at cost; 126 shares | (360) | (360) |
| Total stockholders' equity | 7,293 | 10,049 |
| Total liabilities and stockholders' equity | \$ 9,545 | \$ 12,107 |

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

BITSTREAM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|--|---|------------------|--|--------------------|
| | 2001 | 2000 | 2001 | 2000 |
| Revenues: | | | | |
| Software licenses | \$ 1,818 | \$ 2,079 | \$ 4,787 | \$ 5,865 |
| Services | 296 | 163 | 826 | 1,029 |
| Total revenues | 2,114 | 2,242 | 5,613 | 6,894 |
| Cost of revenues: | | | | |
| Software licenses | 348 | 197 | 816 | 564 |
| Services | 124 | 67 | 300 | 534 |
| Total cost of revenues | 472 | 264 | 1,116 | 1,098 |
| Gross profit | 1,642 | 1,978 | 4,497 | 5,796 |
| Operating expenses: | | | | |
| Selling and marketing | 645 | 878 | 2,201 | 2,809 |
| Research and development | 1,191 | 1,126 | 3,784 | 3,621 |
| General and administrative | 511 | 654 | 1,344 | 1,791 |
| Total operating expenses | 2,347 | 2,658 | 7,329 | 8,221 |
| Loss from operations | (705) | (680) | (2,832) | (2,425) |
| Other income: | | | | |
| (Loss) income on investment in DiamondSoft, Inc. | (68) | (10) | (219) | 1 |
| Interest income, net | 47 | 117 | 198 | 355 |
| Loss before provision for income taxes | (726) | (573) | (2,853) | (2,069) |
| Provision for income taxes | 59 | 39 | 139 | 171 |
| Net loss | \$ (785) | \$ (612) | \$ (2,992) | \$ (2,240) |

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| | | | | | | | | |
|---|----|---------|----|---------|----|---------|----|---------|
| Basic and diluted net loss per share | \$ | (0.10) | \$ | (0.08) | \$ | (0.37) | \$ | (0.29) |
| Basic and diluted weighted average shares outstanding | | 8,075 | | 7,811 | | 8,019 | | 7,726 |

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

BITSTREAM INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | For the Nine Months ended September 30, | |
|---|--|-------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | 2001 | 2000 |
| Net loss | \$ (2,992) | \$ (2,240) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 280 | 339 |
| Amortization | 391 | 393 |
| Compensation on grant of stock options | 5 | 14 |
| Loss (income) on investment in DiamondSoft, Inc. | 219 | (1) |
| Changes in assets and liabilities | | |
| Accounts receivable | 975 | (455) |
| Prepaid expenses and other current assets | 127 | 202 |
| Accounts payable | 81 | (53) |
| Accrued expenses | (51) | 135 |
| Deferred revenue | 192 | 153 |
| Long-term liabilities | (28) | (1) |
| Net cash used in operating activities | (801) | (1,514) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (180) | (218) |
| Increase in restricted cash | --- | (300) |
| Investment in DiamondSoft | (250) | --- |
| Change in other assets | (146) | 9 |
| Net cash used in investing activities | (576) | (509) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from the exercise of stock options/warrants | 231 | 463 |
| Net decrease in cash and cash equivalents | (1,146) | (1,560) |
| Cash and cash equivalents, beginning of period | 7,149 | 9,037 |

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| | | | | |
|--|----|-------|----|-------|
| Cash and cash equivalents, end of period | \$ | 6,003 | \$ | 7,477 |
| Cash paid for Interest | \$ | --- | \$ | 1 |
| Cash paid for Income Taxes | \$ | 188 | \$ | 139 |

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

BITSTREAM INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001
(Unaudited)

(1) Significant Accounting Policies

BASIS OF PRESENTATION

The consolidated financial statements of Bitstream Inc. (the "Company" or Bitstream) presented herein, without audit, have been prepared pursuant to the rules of the Securities and Exchange Commission (the SEC) for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures required by generally accepted accounting principles. The balance sheet information at December 31, 2000 has been derived from the Company's audited consolidated financial statements. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the period ended December 31, 2000 included in the Company's Annual Report on Form 10-K, which was filed by the Company with the SEC on April 2, 2001.

The balance sheet as of September 30, 2001, the statements of operations for the three and nine months ended September 30, 2001 and 2000, the statements of cash flows for the nine months ended September 30, 2001 and 2000, and the notes to each thereof are unaudited, but in the opinion of management include all adjustments necessary for a fair presentation of the consolidated financial position, results of operations, and cash flows of the Company and its subsidiaries for these interim periods.

The results of operations for the three and nine months ended September 30, 2001 may not necessarily be indicative of the results to be expected for the year ending December 31, 2001.

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries: Bitstream World Trade, Inc. (a Delaware corporation), a holding company for Bitstream, B.V. (a Dutch corporation); Mainstream Software Solutions Ltd. (an English corporation); Type Solutions, Inc. (a New Hampshire corporation); Archetype, Inc. (a Delaware corporation); Pageflex, Inc. (a Delaware corporation) and MyFonts.com, Inc. (a Delaware corporation). All material inter-company transactions and balances have been eliminated in consolidation.

REVENUE RECOGNITION

The Company recognizes revenue in accordance with Statement of Position 97-2 (SOP 97-2), *Software Revenue Recognition*, as modified by SOP 98-9, *Modifications of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. The Company derives revenues from software product licenses, professional consulting, and support maintenance services. Licenses and royalty revenues are recognized when persuasive evidence of an agreement exists, the product has been delivered, the Company has no remaining significant obligations with regard to implementation, the fee is fixed or determinable, and collection of the fee is probable.

Licensing fees and royalty revenues include: (1) payments paid by OEM and ISV customers for text imaging and page layout technologies; (2) direct and indirect sales of software publishing applications for the creation, enhancement, management, transport, viewing and printing of electronic information; (3) direct sales of custom and other type products to end users such as graphic artists, desktop publishers and corporations; and (4) sales of type products to foreign customers primarily through distributors. Certain OEM and ISV customers pay royalties only upon the sublicensing of the Company's products to end users. Royalties due from these OEM and ISV customers are recognized when such sublicenses are reported to the Company by the OEM or ISV customer.

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

Revenue from guaranteed minimum royalty licenses is recognized upon delivery of the software since no further obligations of the Company exist, while revenue on pay-as-you-go licenses is recognized in the period when sublicenses to end users are reported to the Company by the OEM or ISV customer. In certain guaranteed minimum royalty licenses, the Company will enter into extended payment programs with creditworthy customers. Revenue related to extended payment programs is recognized when payment becomes due to the Company.

Revenue from end user product sales is recognized upon delivery of the software, net of estimated returns and allowances, if there are no significant post delivery obligations and if collection is probable. Revenue from maintenance contracts is recognized pro rata over the term of the maintenance contract. Revenue on certain long-term development contracts is recognized using the percent-of-completion method, as the services are performed. Provisions for any estimated losses on uncompleted contracts are made in the period in which such losses become probable. Revenue related to the extended payment programs is recognized when payment becomes due to the Company.

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

Cost of revenues consists primarily of costs associated with consulting and custom product development services. Costs also include costs to distribute the product, including the cost of the media on which it is delivered. Additional costs include fees paid to third parties for the development of unique typeface designs and costs associated with fulfilling such orders.

The Company generally warrants that its products will function substantially in accordance with documentation provided to customers for approximately 90 days following initial delivery. As of September 30, 2001, the Company had not incurred any significant expenses related to warranty claims.

RECLASSIFICATIONS

Certain prior year account balances have been reclassified to be consistent with the current year's presentation.

RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2000, the Financial Accounting Standards Board (FASB) issued SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Under SFAS No. 140, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. SFAS No. 140 also provides standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. SFAS No. 140 is effective for certain transactions occurring after March 31, 2001 and certain disclosures for the year ending December 31, 2001. The Company has adopted SFAS No. 140, which did not have a material impact on the Company's financial position or results of operations.

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. This statement, as amended by SFAS No. 137 and SFAS No. 138, is effective for fiscal years ending December 31, 2001 and thereafter. The Company has adopted SFAS No. 133 as amended, which did not have a material impact on the Company's financial position or results of operations.

On June 29, 2001, the FASB issued SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. These statements establish new standards for accounting for business combinations, goodwill, and intangible assets. Statement 141 eliminates the pooling-of-interests method of accounting for business combinations except for qualifying business combinations that were initiated prior to July 1, 2001 and changes the criteria to recognize intangible assets apart from goodwill. The requirements of Statement 141 are effective for any business combination accounted for by the purchase method that is completed after June 30, 2001. Statement 142 supersedes APB Opinion No. 17, *Intangible Assets* (which required that goodwill and intangible assets be amortized over a life not to exceed 40 years), and carries forward its provisions related to internally developed intangible assets without the FASB's reconsideration. Under Statement 142, goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed annually for impairment, or more frequently if impairment indicators arise. Goodwill is required to be tested for impairment between the annual tests if an event occurs or circumstances change that more-likely-than-not reduce the fair value of a reporting unit below its carrying value. An indefinite-lived intangible asset is required to be tested for impairment between the annual tests if an event occurs or circumstances change indicating that the asset might be impaired. Separable intangible assets that have finite lives will continue to be amortized over their useful lives, for which Statement 142 does not impose a limit. Any required goodwill impairment charges would be presented as a separate line item within the operating section of the income statement. The Company has adopted Statement 141, which did not have a material impact on the Company's financial position or results of operations. The Company is required to adopt Statement 142 on January 1, 2002 and is currently evaluating the impact on the Company's financial position and results of operations.

In August 2001, the FASB issued SFAS no. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supersedes SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of and APB no. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. This statement provides guidance on recognizing and measuring impairment for long-lived assets excluding certain long-lived assets, such as goodwill, non-amortized intangible assets and deferred tax assets. This statement is effective for the Company in the first quarter of its fiscal year ending December 2002. Management is currently evaluating the impact that this statement will have on the Company's financial statements.

(2) Property and Equipment (in thousands)

Property and equipment are stated at cost, less accumulated depreciation and amortization. Property and equipment consists of the following:

| | September 30, 2001 | | December 31, 2000 |
|--|-----------------------|----|----------------------|
| Office and computer equipment | 2,408 | \$ | 2,069 |
| Purchased software | 348 | | 347 |
| Equipment under capital lease | --- | | 167 |
| Furniture and fixtures | 372 | | 366 |
| Leasehold improvements | 659 | | 659 |
| | 3,787 | | 3,608 |
| Less Accumulated depreciation and amortization | 3,251 | | 2,972 |
| Property and equipment, net | 536 | \$ | 636 |

(3) Concentration of Credit Risk

SFAS No. 105, *Disclosure of Information About Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentration of Credit Risk*, requires disclosure of any significant off-balance sheet and credit risk concentrations. Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents and trade accounts receivable. The Company places a majority of its cash investments in one financial institution. The Company has not experienced significant losses related to receivables from any individual customers or groups of customers in any specific industry or by geographic area. Due to these factors, no additional credit risk beyond amounts provided for collection losses is believed by management to be inherent in the Company's accounts receivable.

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At September 30, 2001, one customer accounted for 30% each of the Company's accounts receivable. At December 31, 2000, one customer accounted for 18% of the Company's accounts receivable. The Company does not have any financial instruments with off-balance sheet risk as of September 30, 2001. For the three months ended September 30, 2001 two customers accounted for 18% and 8%, respectively, of the Company's revenue. For the nine months ended September 30, 2001, no customers accounted for more than 10% of the Company's revenue. For the three months ended September 30, 2000, one customer accounted for 11% of the Company's revenue. For the nine months ended September 30, 2000, one customer accounted for 12% of the Company's revenue.

For the three months ended September 30, 2001, two customers of the Company's type and technology segment accounted for 24% and 10%, respectively, of that segment's revenue, and one customer of the Pageflex segment accounted for 13% of that segment's revenue. For the nine months ended September 30, 2001, one customer of the Company's type and technology segment accounted for 10% of that segment's revenue, and no customers of the Pageflex segment accounted for 10% or more of that segment's revenue. For the three months ended September 30, 2000, one customer of the Company's type and technology segment accounted for 16% of the revenue for that segment, and three customers of the Pageflex segment accounted for 32%, 15% and 14%, respectively, of that segment's revenue. For the nine months ended September 30, 2000, no customers of the Company's type and technology segment accounted for 10% or more of the revenue for that segment, while two customers of the Pageflex segment accounted for 42% and 16%, respectively, of that segment's revenue.

The Company's MyFonts.com segment had no customers responsible for 10% or more of its accounts receivable balance as of September 30, 2001 or December 31, 2000, and had no customers that accounted for 10% or more of its revenue for the three or nine months ended September 30, 2001 or 2000.

(4) Accrued Expenses (in thousands)

(4) Accrued Expenses (in thousands)

Accrued expenses consist of the following:

| | September 30, | | December 31, |
|--|----------------------|-----------|---------------------|
| | 2001 | | 2000 |
| Accrued royalties | \$ 271 | \$ | 210 |
| Payroll and other compensation | 595 | | 648 |
| Accrued professional and consulting services | 98 | | 169 |
| Other | 272 | | 260 |
| Total | \$ 1,236 | \$ | 1,287 |

(5) Loss Per Share (in thousands)

In accordance with SFAS No. 128, *Earnings Per Share*, basic loss per share was determined by dividing net loss by the weighted average shares of common stock outstanding during the applicable period. Diluted loss per share reflects dilution from potentially dilutive securities, primarily stock options based on the treasury stock method. In computing diluted loss per share, common stock equivalents are not considered in periods in which a net loss is reported, as the inclusion of the potential common stock equivalents would be antidilutive. Thus potential common shares were not included for the three or nine months ended September 30, 2001 or 2000. Had the numerator been a profit, the potential common shares would have increased the weighted average shares outstanding by 1,262 and 1,543 shares for the nine months ended September 30, 2001 and 2000, respectively, and by 993 and 2,003 for the nine months ended September 30, 2001 and 2000, respectively. In addition, there were warrants and options to purchase 262 and 235 shares for the three months ended September 30, 2001 and 2000, respectively, and 278 and 116 shares for the nine months ended September 30, 2001 and 2000, respectively, that were not included in the potential common share computations because their exercise prices were greater than the market price of the Company's common stock. These common stock equivalents are antidilutive even when a profit is reported in the numerator.

(6) Segment Reporting (in thousands)

The Company has three reportable business segments: (1) its type and technology segment, (2) its Pageflex segment, and (3) its MyFonts.com segment. The Company's reportable segments are strategic business units that sell the Company's products through distinct distribution channels. They are managed separately as each business requires different marketing strategies. The Company's approach is based on the way that management organizes the segments within the enterprise for making operating decisions and assessing performance. MyFonts.com's revenues include revenue generated from the sale of products it purchases from the type and technology segment. The inter-segment revenues created by these transactions have been eliminated from MyFonts.com's revenue below, as well as from the Company's consolidated financial statements. The Company evaluates performance based on profit or loss from operations before income taxes, not including non-recurring gains and losses.

| Revenue (from external customers): | Three months ended | | Nine months ended | |
|---|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2001 | 2000 | 2001 | 2000 |
| Type and technology | \$ 1,414 | \$ 1,610 | \$ 3,767 | \$ 4,869 |
| MyFonts.com | 144 | 7 | 337 | 9 |
| Pageflex | 556 | 625 | 1,509 | 2,016 |
| Consolidated revenue | \$ 2,114 | \$ 2,242 | \$ 5,613 | \$ 6,894 |
| Segment (loss) income from operations: | | | | |
| Type and technology | \$ 248 | \$ 339 | \$ 64 | \$ 822 |
| MyFonts.com | (263) | (97) | (584) | (310) |
| Pageflex | (690) | (922) | (2,312) | (2,937) |

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| | | | | | | | | |
|-----------------------------------|----|--------|----|--------|----|----------|----|----------|
| Consolidated loss from operations | \$ | (705) | \$ | (680) | \$ | (2,832) | \$ | (2,425) |
|-----------------------------------|----|--------|----|--------|----|----------|----|----------|

(7) Geographical Reporting (in thousands)

The Company attributes revenues to different geographical areas on the basis of the location of the customer. All of the Company's product sales for the three and nine months ended September 30, 2001 and 2000 were shipped from its headquarters located in the United States or its office located in Cheltenham, England. Revenues by geographic area are as follows:

| Revenue: | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|----------|
| | 2001 | 2000 | 2001 | 2000 |
| United States | \$ 1,078 | \$ 1,381 | \$ 2,914 | \$ 4,436 |
| Canada | 94 | 82 | 296 | 269 |
| Japan | 221 | 343 | 796 | 868 |
| Korea | 374 | --- | 432 | --- |
| United Kingdom | 142 | 217 | 425 | 454 |
| Other (countries less than 5% individually, by region): | | | | |
| Europe, excluding UK | 195 | 185 | 701 | 717 |
| Asia, excluding those specified above | 10 | 34 | 49 | 150 |
| Total revenue | \$ 2,114 | \$ 2,242 | \$ 5,613 | \$ 6,894 |

Long-lived tangible assets by geographic area are as follows:

| | September 30, | | December 31, | |
|---------------|---------------|----|--------------|--|
| | 2001 | | 2000 | |
| United States | \$ 520 | \$ | 628 | |
| England | 16 | | 8 | |
| Total | \$ 536 | \$ | 636 | |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.

OVERVIEW

Bitstream Inc. (Bitstream or the Company), headquartered in Cambridge, Massachusetts, is composed of three separate and distinct businesses: (1) type and technology, in which Bitstream develops and licenses font technology and custom font designs to manufacturers of Internet appliances, wireless devices, set-top boxes, embedded systems, printers, and personal digital assistants; (2) MyFonts.com, a showcase of the world's fonts in one easy-to-use e-commerce web site operated by Bitstream's wholly-owned subsidiary, MyFonts.com, Inc. (MyFonts.com); and (3) Pageflex, formerly referred to as the Company's on-demand marketing segment, in which the Company's wholly-owned subsidiary Pageflex, Inc. (Pageflex) develops, markets and supports on-demand document composition solutions which automatically produce customized one-to-one marketing collateral such as datasheets and brochures directly from XML text and graphics data stored in web servers and/or databases.

FORWARD LOOKING STATEMENTS

Except for the historical information contained herein, this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Investors are cautioned that forward-looking statements are inherently uncertain. Actual performance and results of operations may differ materially from those projected or suggested in the forward-looking statements due to certain risks and uncertainties, including, without limitation, market acceptance of the Company's products, competition and the timely introduction of new products. Additional information concerning certain risks and uncertainties that would cause actual results to differ materially from those projected or suggested in the forward-looking statements is contained in the Company's filings with the Securities and Exchange Commission, including those risks and uncertainties discussed in the Company's final Prospectus, dated October 30, 1996, included as part of the Company's Registration Statement on Form S-1 (333-11519), in the section entitled "Risk Factors", and in the Company's 2000 Annual Report on Form 10-K filed on April 2, 2001. The forward-looking statements contained herein represent the Company's judgment as of the date of this report, and the Company cautions readers not to place undue reliance on such statements. Management undertakes no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

RESULTS OF OPERATIONS (in thousands, except percent amounts)**Consolidated Revenues:**

| | September 30, | | | | | |
|---------------------|---------------|-----------------|----------|-----------------|-------------|----------|
| | 2001 | % of Revenue | 2000 | % of Revenue | Change | |
| | | | | | Dollars | Percent |
| Three months ended: | | | | | | |
| Software licenses | \$ 1,818 | 86.0 % | \$ 2,079 | 92.7 % | \$ (261) | (12.6)% |
| Services | 296 | 14.0 % | 163 | 7.3 % | 133 | 81.6 % |
| Total revenues | \$ 2,114 | 100.0 % | \$ 2,242 | 100.0 % | \$ (128) | (5.7)% |
| Nine months ended: | | | | | | |
| Software licenses | \$ 4,787 | 85.3 % | \$ 5,865 | 85.1 % | \$ (1,078) | (18.4)% |
| Services | 826 | 14.7 % | 1,029 | 14.9 % | (203) | (19.7)% |
| Total revenues | \$ 5,613 | 100.0 % | \$ 6,894 | 100.0 % | \$ (1,281) | (18.6)% |

The decrease in revenue for the three months ended September 30, 2001 as compared to the three months ended September 30, 2000 was attributable to decreases in revenue for the type and technology segment of \$196 and the Pageflex segment of \$69, partially offset by an increase in MyFonts.com revenues of \$137. The decrease in revenue for the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000 was attributable to decreases in revenue for the type and technology segment of \$1,102 and the Pageflex segment of \$507, partially offset by an increase in MyFonts.com revenues of \$328. These segments are discussed in more detail below.

Type and Technology Revenues:

| | September 30, | | September 30, | | Change | |
|------------------------------|---------------|--------------|---------------|--------------|-------------|----------|
| | 2001 | % of Revenue | 2000 | % of Revenue | Dollars | Percent |
| Three months ended: | | | | | | |
| Software licenses | \$ 1,308 | 92.5 % | \$ 1,547 | 96.1 % | \$ (239) | (15.5)% |
| Services | 106 | 7.5 % | 63 | 3.9 % | 43 | 68.3 % |
| Type and technology revenues | \$ 1,414 | 100.0 % | \$ 1,610 | 100.0 % | \$ (196) | (12.2)% |
| Percentage of total revenues | 66.9 % | | 71.8 % | | | |
| Nine months ended: | | | | | | |
| Software licenses | \$ 3,410 | 90.5 % | \$ 4,595 | 94.4 % | \$ (1,185) | (25.8)% |
| Services | 357 | 9.5 % | 274 | 5.6 % | 83 | 30.3 % |
| Type and technology revenues | \$ 3,767 | 100.0 % | \$ 4,869 | 100.0 % | \$ (1,102) | (22.6)% |
| Percentage of total revenues | 67.1 % | | 70.6 % | | | |

The decrease in type and technology license revenues for the three months and nine months ended September 30, 2001 versus the three and nine months ended September 30, 2000 was due to decreases in OEM technology licensing of \$85 and \$791, respectively, decreases in reseller sales of \$99 and \$111, respectively, and decreases in retail sales of \$55 and \$283, respectively. These decreases were primarily due to the softening of the market for high technology products in general and increased concern over future economic conditions. Service revenue increased \$43 and \$83, respectively, for the three and nine month periods ended September 30, 2001 primarily because of the increased maintenance base resulting from the sale of type and technology software products.

MyFonts.com Revenues:

| | September 30, | | | |
|------------------------------|---------------|-------|---------|---------|
| | 2001 | 2000 | Change | |
| | | | Dollars | Percent |
| Three months ended: | | | | |
| Software licenses | \$ 144 | \$ 7 | \$ 137 | 1,957 % |
| Percentage of total revenues | 6.8 % | 0.3 % | | |
| Nine months ended: | | | | |
| Software licenses | \$ 337 | \$ 9 | \$ 328 | 3,644 % |
| Percentage of total revenues | 6.0 % | 0.1 % | | |

MyFonts.com's revenue, prior to the elimination of inter-company royalties paid to Bitstream's type and technology segment, increased by \$174 to \$198 for the three months ended September 30, 2001 as compared to \$24 for the three months ended September 30, 2000, and by \$437 to \$469 for the nine months ended September 30, 2001 as compared to \$32 for the nine months ended September 30, 2000. MyFonts.com began selling through its web site at the end of the first quarter of 2000. Revenue from the MyFonts.com web site and revenue that it earns from managing the e-commerce portion of Bitstream's web site have increased each quarter since its inception.

Pageflex Revenues:

| | September 30, | | | | | | | |
|------------------------------|---------------|--------------|----------|---------|--------------|--|----------|--|
| | 2001 | % of Revenue | | 2000 | % of Revenue | | Change | |
| | | | | | Dollars | | Percent | |
| Three months ended: | | | | | | | | |
| Software licenses | \$ 366 | 65.8 % | \$ 525 | 84.0 % | \$ (159) | | (30.3)% | |
| Services | 190 | 34.2 % | 100 | 16.0 % | 90 | | 90.0 % | |
| Pageflex revenues | \$ 556 | 100.0 % | \$ 625 | 100.0 % | \$ (69) | | (11.0)% | |
| Percentage of total revenues | | 26.3 % | | 27.9 % | | | | |
| Nine months ended: | | | | | | | | |
| Software licenses | \$ 1,040 | 68.9 % | \$ 1,261 | 62.6 % | \$ (221) | | (17.5)% | |
| Services | 469 | 31.1 % | 755 | 37.4 % | (286) | | (37.9)% | |
| Pageflex revenues | \$ 1,509 | 100.0 % | \$ 2,016 | 100.0 % | \$ (507) | | (25.2)% | |
| Percentage of total revenues | | 26.9 % | | 29.3 % | | | | |

The decrease in license revenue for the Pageflex segment for the three and nine months ended September 30, 2001 as compared to the three and nine months ended September 30, 2000 was attributable to the decrease in non-recurring OEM licensing fees from an existing long-term contract with Atex Media Solutions, Inc. (Atex) of \$168 and \$504, respectively. Pageflex license revenues increased \$9 and \$283, respectively, for the three months and nine months ended September 30, 2001 as compared to the three months and nine months ended September 30, 2000, excluding the Atex license fees, primarily due to increases in direct sales and subscriptions of the Company's Mpower product. The increase in service revenue during the three months ended September 30, 2001 as compared to the three months ended September 30, 2000 is attributable to the increase in Pageflex's customer support revenue base which consists of customers who have contracted for support maintenance. Revenues from services decreased during the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000 as a result of the completion of certain non-recurring consulting projects during the first six months of 2000, which primarily consisted of non-recurring engineering for Atex.

Consolidated Gross Profit:

| | September 30, | | Change | |
|-----------------------------|---------------|----------|-------------|----------|
| | 2001 | 2000 | Dollars | Percent |
| Three months ended: | | | | |
| Gross profit | \$ 1,642 | \$ 1,978 | \$ (336) | (17.0)% |
| Percentage of total revenue | 77.7 % | 88.2 % | | |
| Nine months ended: | | | | |
| Gross profit | \$ 4,497 | \$ 5,796 | \$ (1,299) | (22.4)% |
| Percentage of total revenue | 80.1 % | 84.1 % | | |

The decrease in the gross profit for the three months and nine months ended September 30, 2001 as compared to the three months and nine months ended September 30, 2000 is primarily attributable to decreases in revenues discussed above totaling \$128 and \$1,281, respectively, and an increase in cost of revenues totaling \$208 and \$18, respectively. Type and technology's cost of revenues increased \$62 to \$256 for the three months ended September 30, 2001 from \$194 for the three months ended September 30, 2000 primarily because of several large license agreements involving larger than normal third party royalties. The type and technology cost of revenues decreased \$85 to \$602 for the nine months ended September 30, 2001 from \$687 for the nine months ended September 30, 2000 primarily because of the elimination of outside subcontractors whose services were utilized during 2000 and a reduction in time spent by type engineers on customer specific projects, partially offset by the increase in royalties during the three months ended September 30, 2001. Pageflex's cost of revenues increased \$35 to \$102 for the three months ended September 30, 2001 from \$67 for the three months ended September 30, 2000 primarily because of increased support costs and the use of an outside consultant for consulting services. Pageflex's cost of revenues decreased \$156 to \$251 for the nine months ended September 30, 2001 from \$407 for the nine months ended September 30, 2000 as a result of a decreased amount of consulting performed by the Company, which has a higher cost than licensing revenue. Cost of revenues for the nine months ended September 30, 2000 included \$67 of non-recurring development costs associated with Atex consulting revenue occurring in the first six months of 2000, partially offset by the increases mentioned above for the three months ended September 30, 2001. MyFonts.com's cost of revenues consist of royalties paid to third party font foundries for the sale of their fonts. These costs increased \$111 and \$259 for the three and nine months ended September 30, 2001 as compared to the three and nine months ended September 30, 2000 as a result of the increased volume of sales on the MyFonts.com web site.

Cost of revenue is composed of direct costs of licenses, as well as direct costs of product sales to end-users. Included in the cost of licenses are fees paid to third parties for the development or license of rights to technology and/or unique typeface designs and costs incurred in the fulfillment of custom orders from OEM and ISV customers. Included in cost of product sales to end users and distributors are the direct costs associated with the duplication, packaging and shipping of product.

Consolidated Selling and Marketing:

| | September 30, | | Change | |
|-----------------------------|---------------|----------|-----------|----------|
| | 2001 | 2000 | Dollars | Percent |
| Three months ended: | | | | |
| Selling and marketing | \$ 645 | \$ 878 | \$ (233) | (26.5)% |
| Percentage of total revenue | 30.5 % | 39.2 % | | |
| Nine months ended: | | | | |
| Selling and marketing | \$ 2,201 | \$ 2,809 | \$ (608) | (21.6)% |
| Percentage of total revenue | 39.2 % | 40.8 % | | |

Selling and marketing expenses for the type and technology segment decreased \$60 or 15.3% and \$85 or 7.1% to \$333 and \$1,111 for the three and nine months ended September 30, 2001, respectively, from \$393 and \$1,196 for the three and nine months ended September 30, 2000, respectively. Selling and marketing costs associated with the Pageflex segment decreased \$211 or 44.0% and \$570 or 35.6% to \$269 and \$1,032 for the three and nine months ended September 30, 2001, respectively, from \$480 and \$1,602 for the three and nine months ended September 30, 2000, respectively. These reductions resulted from management's decision to reduce marketing expenses including the Company's trade show expenses and from non-recurring costs related to new product introductions and branding which took place on a limited basis during the first two quarters of 2000. Selling and marketing expenses for the MyFonts.com segment increased \$38 or 760% and \$47 or 427% to \$43 and \$58 for the three and nine months ended September 30, 2001, respectively, from \$5 and \$11 for the three and nine months ended September 30, 2000, respectively. These increases were primarily due to advertising costs, which the Company did not incur in 2000.

Consolidated Research and Development (R&D):

| | September, 30 | | Change | |
|-----------------------------|---------------|----------|---------|---------|
| | 2001 | 2000 | Dollars | Percent |
| Three months ended: | | | | |
| Research and development | \$ 1,191 | \$ 1,126 | \$ 65 | 5.8 % |
| Percentage of total revenue | 56.3 % | 50.2 % | | |
| Nine months ended: | | | | |
| Research and development | \$ 3,784 | \$ 3,621 | \$ 163 | 4.5 % |
| Percentage of total revenue | 67.4 % | 52.5 % | | |

R&D costs associated with the type and technology segment decreased \$15 or 3.8% and increased \$11 or less than one percent from \$396 and \$1,299 for the three months and nine months ended September 30, 2000, respectively, to \$381 and \$1,310 for the three months and nine months ended September 30, 2001, respectively. R&D costs associated with the Myfonts.com segment increased \$154 or 186% and \$272 or

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96.8% from \$83 and \$281 for the three and nine months ended September 30, 2000, respectively, to \$237 and \$553 for the three and nine months ended September 30, 2001, respectively. The increased MyFonts.com expenses relate to employee and subcontractor costs for further development to the MyFonts.com web site. The Company's management expects this expense to decrease in future quarters as the site becomes more mature.

R&D costs associated with the Pageflex segment decreased \$74 or 11.4% and \$120 or 5.9%, from \$647 and \$2,041 for the three months and nine months ended September 30, 2000, respectively, to \$573 and \$1,921 for the three months and nine months ended September 30, 2001, respectively. The Pageflex decrease was due to the decrease in use of sub-contractors primarily engaged in the quality analysis and testing of the Japanese version of Mpower released in 2000.

Consolidated General and Administrative (G&A)

| | September 30, | | Change | |
|-----------------------------|---------------|----------|-----------|----------|
| | 2001 | 2000 | Dollars | Percent |
| Three months ended: | | | | |
| General and administrative | \$ 511 | \$ 654 | \$ (143) | (21.9)% |
| Percentage of total revenue | 24.2 % | 29.2 % | | |
| Nine months ended: | | | | |
| General and administrative | \$ 1,344 | \$ 1,791 | \$ (447) | (25.0)% |
| Percentage of total revenue | 23.9 % | 26.0 % | | |

G&A costs associated with the type and technology segment decreased \$92 or 31.9% and \$185 or 21.4%, from \$288 and \$865 for the three months and nine months ended September 30, 2000, respectively, to \$196 and \$680 for the three months and nine months ended September 30, 2001, respectively. Bad debt expense decreased \$84 and \$372 for the three months and nine months ended September 30, 2001, respectively, as compared to the three months and nine months ended September 30, 2000. Bad debt expense decreases resulted from the net decrease in reserves for doubtful accounts during the first six months of 2001 resulting from the collection of several accounts receivable balances which had been reserved for during the year ended December 31, 2000. G&A expenses, excluding bad debt activity, decreased \$8 for the three months ended September 30, 2001 as compared to the three months ended September 30, 2000, but increased \$185 for the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000. The increase is primarily attributable to increases in professional service fees of \$56 and facilities related costs of \$83, for the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000. G&A costs associated with the Pageflex segment decreased \$51 or 14.5% and \$286 or 31.7% from \$353 and \$903 for the three months and nine months ended September 30, 2000, respectively, to \$302 and \$617 for the three months and nine months ended September 30, 2001, respectively. Bad debt expense increased \$1 for the three months ended September 30, 2001 as compared to the three months ended September 30, 2000, but decreased \$251 for the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000. G&A expenses, excluding bad debt activity, decreased \$51 and \$33 for the three months and nine months ended September 30, 2001 as compared to the three months and nine months ended September 30, 2000, respectively. G&A costs associated with the MyFonts.com segment were unchanged at \$13 for the three months ended September 30, 2001 and 2000, but increased \$24 from \$23 for the nine months ended September 30, 2000 to \$47 for the nine months ended September 30, 2001.

A significant portion of the Company's operating expenses are fixed, and planned expenditures in any given quarter are based on sales and revenue forecasts. Accordingly, if products are not completed and/or shipped on schedule and revenues do not meet the Company's expectations in any given quarter, the Company's operating results and financial condition could be adversely affected.

(Loss) Income on Investment in DiamondSoft, Inc.:

The Company made a \$500 equity investment in DiamondSoft, Inc. in March of 1998 and made additional investments totaling \$150 during the three months ended March 31, 2001 and \$100 during the three months ended June 30, 2001. As of September 30, 2001 the Company's ownership percentage in DiamondSoft, Inc. is 28%. DiamondSoft, Inc. is a California corporation primarily engaged in the business of developing, marketing and distributing software tools to a variety of professional markets. The Company recognizes its share of DiamondSoft's income or loss during each quarter and recorded losses of \$68 and \$10 for the three months ended September 30, 2001 and 2000, respectively, and a loss of \$(219) and income of \$1 for the nine months ended September 30, 2001 and 2000, respectively.

Interest income, net:

Interest income consists primarily of interest income earned on the Company's cash equivalents.

Provision for income taxes:

The Company's income tax expense for the three and nine months ended September 30, 2001 and 2000 primarily represents foreign income taxes.

LIQUIDITY AND CAPITAL RESOURCES (in thousands)

The Company has funded its operations primarily through the public sale of equity securities, cash flows from operations and cash received from the sale of the Company's MediaBank and InterSep OPI product lines to Inso Providence Corporation in August of 1998. As of September 30, 2001, the Company had net working capital of \$4,901 versus \$7,371 at December 31, 2000.

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The Company used \$801 of its cash to support its operating activities during the nine months ended September 30, 2001 as compared to \$1,514 during the nine months ended September 30, 2000. The net cash used during the nine months ended September 30, 2001 was primarily due to the consolidated loss partially offset by the collection of \$975 in receivables during the period. The net cash used during the nine months ended September 30, 2000 was primarily due to the net losses from the Pageflex and MyFonts.com businesses, partially offset by the income from the type and technology business. The net loss adjusted for non-cash expenses resulted in a use of \$2,097 and \$1,495 in cash during the nine months ended September 30, 2001 and 2000, respectively.

The Company used \$576 of its cash for investing activities during the nine months ended September 30, 2001 as compared to \$509 during the nine months ended September 30, 2000. The Company used \$180 and \$218 of its cash to purchase property and equipment during the nine months ended September 30, 2001 and 2000, respectively. During the nine months ended September 30, 2001, the Company made additional investments in DiamondSoft, Inc. totaling \$250. For the nine months ended September 30, 2000 the Company also used \$300 to secure a \$300 line of credit granted by Wells Fargo Bank to DiamondSoft, Inc. This cash is presented on the Company's consolidated balance sheet as restricted cash.

The Company's financing activities provided cash of \$231 and \$463 for the nine months ended September 30, 2001 and 2000, respectively, from the exercise of stock options.

The Company believes its current cash and cash equivalent balances will be sufficient to meet the Company's operating and capital requirements for at least the next 12 months. There can be no assurance, however, that the Company will not require additional financing in the future. If the Company were required to obtain additional financing in the future, there can be no assurance that sources of capital will be available on terms favorable to the Company, if at all. As of September 30, 2001, the Company had no material commitments for capital expenditures. From time to time, the Company evaluates potential acquisitions of products, businesses and technologies that may complement or expand the Company's business. Any such transactions consummated may use a portion of the Company's working capital or require the issuance of equity or debt.

In November 1996, the Company completed an initial public offering ("IPO") of 2,415 shares of its Class A Common Stock. Net proceeds from the IPO were approximately \$12,200, of which approximately \$1,500 was used to repay outstanding indebtedness.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2000, the Financial Accounting Standards Board (FASB) issued SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Under SFAS No. 140, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. SFAS No. 140 also provides standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. SFAS No. 140 is effective for certain transactions occurring after March 31, 2001 and certain disclosures for the year ending December 31, 2001. The Company has adopted SFAS No. 140, which did not have a material impact on the Company's financial position or results of operations.

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. This statement, as amended by SFAS No. 137 and SFAS No. 138, is effective for fiscal years ending December 31, 2001. The Company has adopted SFAS No. 133 as amended, which did not have a material impact on the Company's financial position or results of operations.

On June 29, 2001, the FASB issued SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. These statements establish new standards for accounting for business combinations, goodwill, and intangible assets. Statement 141 eliminates the pooling-of-interests method of accounting for business combinations except for qualifying business combinations that were initiated prior to July 1, 2001 and changes the criteria to recognize intangible assets apart from goodwill. The requirements of Statement 141 are effective for any business combination accounted for by the purchase method that is completed after June 30, 2001. Statement 142 supersedes APB Opinion No. 17, *Intangible Assets* (which required that goodwill and intangible assets be amortized over a life not to exceed 40 years), and carries forward its provisions related to internally developed intangible assets without the FASB's reconsideration. Under Statement 142, goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed annually for impairment, or more frequently if impairment indicators arise. Goodwill is required to be tested for impairment between the annual tests if an event occurs or circumstances change that more-likely-than-not reduce the fair value of a reporting unit below its carrying value. An indefinite-lived intangible asset is required to be tested for impairment between the annual tests if an event occurs or circumstances change indicating that the asset might be impaired. Separable intangible assets that have finite lives will continue to be amortized over their useful lives, for which Statement 142 does not impose a limit. Any required goodwill impairment charges would be presented as a separate line item within the operating section of the income statement. The Company has adopted Statement 141, which did not have a material impact on the Company's financial position or results of operations. The Company is required to adopt Statement 142 on January 1, 2002 and is currently evaluating the impact on the Company's financial position or results of operations.

In August 2001, the FASB issued SFAS no. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supersedes SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of* and APB no. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. This statement provides guidance on recognizing and measuring impairment for long-lived assets excluding certain long-lived assets, such as goodwill, non-amortized intangible assets and deferred tax assets. This statement is effective for the Company in the first quarter of its fiscal year ending December 2002. Management is currently evaluating the impact that this statement will have on the Company's financial statements.

PART 1, ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments.

As of September 30, 2001, the Company did not participate in any derivative financial instruments or other financial and commodity instruments for which fair value disclosure would be required under SFAS No. 107. All of the Company's investments are short-term, investment-grade commercial paper, and money market accounts that are carried on the Company's books at amortized cost, which approximates fair market value. Accordingly, the Company has no quantitative information concerning the market risk of participating in such investments.

Primary Market Risk Exposures

The Company's primary market risk exposures are in the areas of interest rate risk and foreign currency exchange rate risk. The Company's investment portfolio of cash equivalent and short-term investments is subject to interest rate fluctuations, but the Company believes this risk is immaterial due to the short-term nature of these investments. The Company's exposure to currency exchange rate fluctuations has been and is expected to continue to be modest due to the fact that the operations of its international subsidiaries are almost exclusively conducted in their respective local currencies. International subsidiary operating results are translated into U.S. dollars and consolidated for reporting purposes. The impact of currency exchange rate movements on inter-company transactions was immaterial for the three and nine months ended September 30, 2001. Currently the Company does not engage in foreign currency hedging activities.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not a party to any litigation.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(a) Instruments defining the rights of the holders of any class of registered securities of the Company have not been materially modified during the three months ended September 30, 2001.

(b) Rights evidenced by any class of registered securities of the Company have not been materially limited or qualified by the issuance or modification of any other class of securities during the three months ended September 30, 2001.

(c) There were no unregistered securities sold by the Company during the three months ended September 30, 2001.

(d) Use of Proceeds

As of September 30, 2001, the approximately \$12,200,000 of net proceeds from the Company's initial public offering (IPO) of its Class A Common Stock pursuant to its Registration Statement on Form S-1, Commission File No. 333-11519, declared effective October 30, 1996, have been used as follows: (1) approximately \$200,000 for the buildout of Bitstream's leased facilities in Cambridge, Massachusetts to accommodate the additional personnel that joined the Company as a result of the acquisition of Archetype, Inc.; (2) approximately \$6,041,000 for the acquisitions of Mainstream Software Solutions, Ltd., Archetype, Inc., Type Solutions, Inc., and certain assets of Alaras Corporation; (3) approximately \$1,500,000 for the repayment of indebtedness, of which approximately \$548,000 was paid to officers, directors and 10% stockholders of the Company and approximately \$762,000 of which was paid to third parties; (4) approximately \$1,948,000 for royalty payments to others; (5) \$750,000 for the investment in DiamondSoft, Inc.; and (6) approximately \$1,761,000 for the purchase and installation of equipment. The Company has utilized all of the proceeds from the IPO as of the end of the three month period ended September 30, 2001, however, the Company had approximately \$6,003,000 in cash and cash equivalents at September 30, 2001.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Change

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) On June 6, 2001, the Annual Meeting of Stockholders of the Company was held at the Royal Sonesta Hotel, 5 Cambridge Parkway, Cambridge, Massachusetts 02142.

(b) George B. Beitzel, Charles Ying, Amos Kaminski and David G. Lubrano were elected at the Annual Meeting to serve as directors of the Company.

PART 2, ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS (continued)

(c) The following votes were tabulated on the aforementioned proposal:

1. To elect a board of four (4) directors to serve until the next Annual Meeting of Stockholders or until their respective successors are elected and qualified.

| Nominee | For | Withheld Authority |
|----------------|------------|---------------------------|
| George Beitzel | 7,447,679 | 215,776 |
| Amos Kaminski | 7,447,679 | 215,776 |
| David Lubrano | 7,447,679 | 215,776 |
| Charles Ying | 7,445,321 | 218,134 |

(d) Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the three months ended September 30, 2001.

SIGNATURES

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.

BITSTREAM INC.

(Registrant)

| SIGNATURE | TITLE | DATE |
|--|---|------------------|
| /s/ Anna M. Chagnon Anna M. Chagnon | President, Chief Operating Officer, Chief Financial Officer and General Counsel (Principal Financial Officer) | November 9, 2001 |
| /s/ James P. Dore James P. Dore | Corporate Controller (Principal Accounting Officer) | November 9, 2001 |