

BITSTREAM INC
Form 10-Q
May 15, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

OR

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

For the transition period from to

Commission File Number: 0-21541

BITSTREAM INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)
04-2744890
(I.R.S. Employer
Identification No.)
245 First Street, 17th Floor, Cambridge, Massachusetts 02142-1270
(Address of principal executive offices and zip code)
(617) 497-6222
(Registrant's telephone number, including area code)

Indicate by checkmark 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 (the Exchange Act) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by checkmark whether the registrant has submitted electronically and posted on its Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

On May 12, 2009, there were 9,867,505 shares of Class A Common Stock, par value \$0.01 per share issued and outstanding, and no shares of Class B Common Stock, par value \$0.01 per share, issued or outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****BITSTREAM INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)****(Unaudited)**

| | March 31, 2009 | December 31, 2008 |
|---|---------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,057 | \$ 16,162 |
| Accounts receivable, net of allowance of \$149 and \$32 at March 31, 2009 and December 31, 2008, respectively | 1,075 | 1,827 |
| Short-term investments, prepaid expenses and other current assets | 667 | 527 |
| Restricted Cash | 150 | 150 |
| Total current assets | 18,949 | 18,666 |
| Property and equipment, net | 363 | 427 |
| Other long-term assets: | | |
| Goodwill | 727 | 727 |
| Intangible assets, net | 74 | 81 |
| Total other assets | 801 | 808 |
| Total assets | \$ 20,113 | \$ 19,901 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,251 | \$ 832 |
| Accrued payroll and other compensation | 620 | 1,057 |
| Other accrued expenses | 462 | 583 |
| Deferred revenue | 1,845 | 1,937 |
| Total current liabilities | 4,178 | 4,409 |
| Total liabilities | 4,178 | 4,409 |
| Commitments and contingencies (Note 4) | | |
| Stockholders' equity : | | |
| Preferred stock, \$0.01 par value, Authorized 6,000 shares, Issued and outstanding- 0 at March 31, 2009 and December 31, 2008 | | |
| Common stock, \$0.01 par value, Authorized 30,000 Class A and 500 Class B. Class A shares Issued 10,120 and 10,116, and outstanding 9,868 and 9,614 at March 31, 2009 and December 31, 2008, respectively. Class B- Issued and outstanding- 0 at March 31, 2009 and December 31, 2008 | 101 | 101 |

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| | | |
|---|-----------|-----------|
| Additional paid-in capital | 34,843 | 35,725 |
| Accumulated deficit | (17,479) | (17,326) |
| Treasury stock, at cost- 252 and 502 shares at March 31, 2009 and December 31, 2008, respectively | (1,502) | (2,989) |
| Accumulated other comprehensive loss | (28) | (19) |
| Total stockholders' equity | 15,935 | 15,492 |
| Total liabilities and stockholders' equity | \$ 20,113 | \$ 19,901 |

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

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BITSTREAM INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2009 | 2008 |
| Revenue: | | |
| Software licenses | \$ 3,765 | \$ 5,126 |
| Services | 1,236 | 1,243 |
| Total revenue | 5,001 | 6,369 |
| Cost of revenue: | | |
| Software licenses | 1,565 | 2,014 |
| Services | 583 | 581 |
| Cost of revenue | 2,148 | 2,595 |
| Gross profit | 2,853 | 3,774 |
| Operating expenses: | | |
| Marketing and selling | 1,033 | 1,135 |
| Research and development | 1,214 | 1,392 |
| General and administrative | 772 | 647 |
| Total operating expenses | 3,019 | 3,174 |
| Operating income (loss) | (166) | 600 |
| Interest and other income, net | 19 | 96 |
| Total other income and expense | 19 | 96 |
| Income (loss) before provision for income taxes | (147) | 696 |
| Provision for income taxes | 6 | 37 |
| Net income (loss) | \$ (153) | \$ 659 |
| Basic net income (loss) per share | \$ (0.02) | \$ 0.07 |
| Diluted net income (loss) per share | \$ (0.02) | \$ 0.06 |
| Basic weighted average shares outstanding | 9,723 | 9,758 |
| Diluted weighted average shares outstanding | 9,723 | 10,527 |

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

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

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2009 | 2008 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ (153) | \$ 659 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 72 | 75 |
| Amortization | 7 | 9 |
| Share based compensation. | 194 | 155 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 752 | 503 |
| Prepaid expenses and other assets | (146) | (308) |
| Accounts payable | 420 | 201 |
| Accrued payroll and other compensation | (437) | (546) |
| Other accrued expenses | (126) | (82) |
| Deferred revenue | (92) | 99 |
| Deferred rent | | (15) |
| Net cash provided by operating activities | 491 | 750 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment, net | (8) | (42) |
| Additions to intangible assets | | (18) |
| Net cash used in investing activities | (8) | (60) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Purchase of treasury stock | | (1,769) |
| Proceeds from exercise of stock options/warrants | 411 | 114 |
| Net cash provided by (used in) financing activities | 411 | (1,655) |
| Effect of foreign currency exchange rates on cash and cash equivalents | | 1 |
| Net increase (decrease) in cash and cash equivalents | 895 | (965) |
| Cash and cash equivalents, beginning of period | 16,162 | 16,420 |
| Cash and cash equivalents, end of period | \$ 17,057 | \$ 15,455 |

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

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BITSTREAM INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Operations and Significant Accounting Policies

Bitstream Inc. (together with its subsidiaries, Bitstream or the Company) is a software development company focused on bringing unique software products to a wide variety of markets. Today, our core software products include award-winning fonts and font rendering technologies, mobile browsing and messaging technologies and variable data publishing and Web-to-print technologies.

We are subject to risks common to technology-based companies, including dependence on key personnel, rapid technological change, competition from alternative product offerings and larger companies, and challenges to the development and marketing of commercial products and services. We have also experienced net losses in prior years and as of March 31, 2009, have an accumulated deficit of approximately \$17 million.

(a) Use of Estimates

The accompanying condensed consolidated financial statements reflect the application of certain accounting policies as described in this note and elsewhere in the accompanying condensed consolidated financial statements and notes. The preparation of the accompanying condensed consolidated financial statements requires the use of certain estimates by us in determining our assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

(b) Basis of Presentation

Our condensed consolidated financial statements 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 (GAAP). The balance sheet information at December 31, 2008 has been derived from our audited consolidated financial statements but does not include all disclosures required by GAAP. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2008 included in our Annual Report on Form 10-K, which was filed with the SEC on March 31, 2009. The condensed consolidated balance sheet as of March 31, 2009, the condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008, and the condensed consolidated statement of cash flows for the three months ended March 31, 2009 and 2008, and the notes to each are unaudited, but in the opinion of management include all adjustments necessary for a fair presentation of the condensed consolidated financial position, results of operations, and cash flows of the Company for these interim periods. The results of operations for the three months ended March 31, 2009 may not necessarily be indicative of the results to be expected for the year ending December 31, 2009.

Table of Contents**BITSTREAM INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(c) Property and Equipment (in thousands)**

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

| | March 31, 2009 | December 31, 2008 |
|--|-------------------|----------------------|
| Equipment | \$ 2,007 | \$ 1,999 |
| Purchased software | 462 | 462 |
| Furniture and fixtures | 375 | 375 |
| Leasehold improvements | 143 | 143 |
| | 2,987 | 2,979 |
| Less Accumulated depreciation and amortization | 2,624 | 2,552 |
| Property and equipment, net | \$ 363 | \$ 427 |

Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets as follows:

| Asset Classification | Estimated Useful Life |
|------------------------|-----------------------|
| Equipment | 3 Years |
| Purchased software | 3 Years |
| Furniture and fixtures | 5 Years |
| Leasehold improvements | Life of lease |

Depreciation expense for the three months ended March 31, 2009 and 2008 was \$72 and \$75, respectively.

(d) Off-Balance Sheet Risk and Concentration of Credit Risk

Financial instruments that potentially expose us to concentrations of credit risk consist primarily of cash and cash equivalents and trade accounts receivable. We place a majority of our cash investments in one highly-rated financial institution. We have 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 us to be inherent in our accounts receivable. At March 31, 2009, no customer accounted for 10% or more of our accounts receivable. At December 31, 2008, two customers accounted for 17% and 11% of our accounts receivable, respectively. For the three months ended March 31, 2009 and 2008, no single customer accounted for 10% or greater of our revenue. We do not have any off-balance sheet risks as of March 31, 2009 or December 31, 2008, respectively.

Table of Contents**BITSTREAM INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(e) Goodwill and Other Intangible Assets (in thousands)**

We follow the accounting and reporting requirements for goodwill and other intangible assets as required by SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). Under SFAS 142, goodwill and indefinite-lived intangible assets are not amortized, but are required to be reviewed annually for impairment, or more frequently, if impairment indicators arise. We have determined that we do not have separate reporting units and thus goodwill is combined and tested for impairment based upon an enterprise wide valuation. Separable intangible assets that have finite lives are amortized over their useful lives. The components of the Company's amortized intangible assets follow:

| | March 31, 2009 | | | December 31, 2008 | | |
|-------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Marketing-related | \$ 84 | \$ (80) | \$ 4 | \$ 84 | \$ (79) | \$ 5 |
| Technology-based | 599 | (529) | 70 | 599 | (523) | 76 |
| Total | \$ 683 | \$ (609) | \$ 74 | \$ 683 | \$ (602) | \$ 81 |

Amortization expense for finite-lived intangible assets for the three months ended March 31, 2009 and 2008 was \$7 and \$9, respectively. Estimated amortization for the five succeeding years follows:

| Estimated Amortization Expense: | |
|--|--------------|
| 2009, remainder | \$ 20 |
| 2010 | 22 |
| 2011 | 18 |
| 2012 | 11 |
| 2013 | 3 |
| | \$ 74 |

(f) Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss), and adjustments to stockholders' equity for foreign currency translation adjustments. For the purposes of comprehensive income (loss) disclosures, the Company does not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as the Company intends to permanently reinvest undistributed earnings in its foreign subsidiaries in accordance with Accounting Principles Board Opinion 23. Accumulated other comprehensive income consists of foreign exchange gains and losses.

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

The components of comprehensive income (loss) are as follows (in thousands):

| | Three months ended | |
|--|--------------------|---------------|
| | March 31, | |
| | 2009 | 2008 |
| Net income (loss) | \$ (153) | \$ 659 |
| Foreign currency adjustment, net of tax of \$0 | | (9) |
| Total comprehensive income (loss) | \$ (162) | \$ 659 |

Accumulated other comprehensive loss consisted of the following:

| | March 31, 2009 | December 31, 2008 |
|-----------------------------|-------------------|----------------------|
| Foreign currency adjustment | \$ (28) | \$ (19) |

(g) Recently Issued Accounting Standards

On January 1, 2009, we adopted FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per share. FSP EITF 03-6-1 is effective in 2009. The adoption of EITF 03-6-1 has not had a material impact on our consolidated financial statements.

On January 1, 2009, we adopted FASB Staff Position (FSP) 157-2. *Effective date of FASB No. 157, FSP 157-2 delayed the effective date of SFAS 157, Fair Value Measurements* (SFAS 157) for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. The adoption of FSP 157-2 on January 1, 2009 did not have a material impact on our consolidated financial statements.

On January 1, 2009, SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R) became effective for us. This statement significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in process research and development, and restructuring costs. In addition, under this statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS 141R may have a material impact on our consolidated financial statements if or when we enter into a business combination.

On January 1, 2009, SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51 became effective for us. This statement changes the accounting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method significantly changes the accounting for transactions with minority interest holders. As of March 31, 2009, the Company did not have any minority interests.

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BITSTREAM INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. This FSP amends SFAS 107, *Disclosure about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments in interim as well as annual financial statements. This FSP also amends APB 28, *Interim Financial Reporting*, to require those disclosures in all interim financial statements. This standard is effective for periods ending after June 15, 2009. We are currently evaluating the impact that this standard may have on our financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FSP FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which amends the other-than-temporary impairment guidance for debt and equity securities. This standard is effective for periods ending after June 15, 2009. We currently anticipate that the adoption of FSP FAS 115-2 and FSP FAS 124-2 will not have an impact on our consolidated financial statements.

(h) Fair Value of Financial Instruments (in thousands)

Effective January 1, 2008, we implemented Statement of Financial Accounting Standard No. 157 (SFAS 157), *Fair Value Measurement*, for our financial assets and liabilities that are remeasured and reported at fair value at each reporting period, and non-financial assets and liabilities that are remeasured and reported at fair value at least annually.

In accordance with the provisions of FSP No. FAS 157-2, we elected to defer until January 1, 2009 the implementation of SFAS 157 as it relates to its non-financial assets and non-financial liabilities that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis. We adopted SFAS 157 for all nonfinancial assets and nonfinancial liabilities measured at fair value on a non-recurring basis. Examples include goodwill, intangibles, and other long-lived assets. The adoption of SFAS 157 did not have a material impact on our consolidated financial statements.

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. We have certain financial assets and liabilities recorded at fair value (principally cash equivalents and investments) that have been classified as Level 1, 2 or 3 within the fair value hierarchy as described in SFAS 157. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Fair values determined by Level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability.

At March 31, 2009 our assets and liabilities that were measured at fair value on a recurring basis included money market funds of \$10, which were Level 1 financial assets.

The carrying amounts reflected in the consolidated balance sheets for restricted cash, accounts receivable, other current assets, accounts payable, and accrued expenses and other current liabilities approximate fair values due to their short-term maturities.

Table of Contents**BITSTREAM INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(i) Foreign Currency Translation**

The financial statements of our foreign subsidiaries are translated in accordance with SFAS No. 52, *Foreign Currency Translation*. The functional currency for our foreign subsidiaries is the applicable local currency. For financial reporting purposes, assets and liabilities of subsidiaries outside the United States of America are translated into U.S. dollars using year-end exchange rates. Revenue and expense accounts are translated at the monthly average rates in effect during the year. The effects of foreign currency translation adjustments are included in accumulated other comprehensive income as a component of stockholders' equity. Transaction gains (losses) for the three months ended March 31, 2009 and 2008 were \$14, and \$ 0, respectively and were recorded as interest and other income, net in the consolidated statements of operations.

(2) Income Per Share (in thousands):

Basic earnings per share is determined by dividing the net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect the effect of the conversion of potentially dilutive securities, such as stock options, warrants, and restricted shares, based on the treasury stock method. In computing diluted earnings per share, common stock equivalents are not considered in periods in which a net loss is reported, as the inclusion of the common stock equivalents would be antidilutive. A reconciliation of basic and diluted weighted average shares outstanding for basic and diluted earnings per share is as follows:

| | Three Months Ended | |
|--|---------------------------|---------------|
| | March 31, | |
| | 2009 | 2008 |
| Basic weighted average shares outstanding | 9,723 | 9,758 |
| Dilutive effect of options | | 769 |
| Dilutive effect of warrants | | |
| Dilutive effect of unvested restricted shares | | |
| Shares used to compute diluted net income per share | 9,723 | 10,527 |

If we had reported a profit for the three months ended March 31, 2009, potential common shares would have increased the weighted average shares outstanding by 405. In addition, there were unvested restricted shares and options outstanding to purchase 693 and 494 shares for the three months ended March 31, 2009 and 2008, respectively, that were not included in the potential common share computations because their exercise prices were greater than the average market price of our common stock during the applicable period.

(3) Equity-Based Compensation Expense (in thousands)

We currently estimate the fair value of share-based awards using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of share-based awards include the exercise price of the award, the expected option term, the expected volatility of our stock over the option's expected term, the risk-free interest rate over the option's expected term, and our expected annual dividend yield. We do not anticipate paying any cash dividends in the foreseeable future and, therefore, use an expected dividend yield of zero in the option valuation model. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. We believe that the

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

valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards. These amounts, and the amounts applicable to future quarters, are also subject to future quarterly adjustments based upon a variety of factors, which include but are not limited to, the issuance of new share-based awards.

The following table summarizes the weighted average assumptions we utilized for grants of share-based awards during the three months ended March 31, 2009 and 2008:

| | Three Months Ended March 31, | |
|--------------------------|---|-------------|
| | 2009 * | 2008 |
| Risk-free interest rates | | 2.8% |
| Expected dividend yield | | None |
| Expected term | | 5.7 Years |
| Expected volatility | | 84.7% |

* No share-based awards were granted during the three months ended March 31, 2009.

All share-based awards granted have a contractual ten-year term. All options granted vest in equal installments on the first, second, third, and fourth year anniversary over a four-year period of continuous employee service. All restricted shares granted vest in equal installments on the first, second, third, fourth, and fifth year anniversary over a five-year period of continuous employee service. The risk-free interest rate utilized is based upon published U.S. Treasury yield curves at the date of the grant for the expected option term. Expected stock price volatility is based upon the historical volatility of our common stock price over the expected term of the option. We use historical exercise, forfeiture, and cancellation information to determine expected term and forfeiture rates.

Our results for the three months ended March 31, 2009 and 2008 include \$194 and \$155, respectively, of share-based compensation within the applicable expense classification where we report the share-based award holders' compensation expense. The following table presents share-based compensation expense included in our condensed consolidated statement of operations:

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2009 | 2008 |
| Cost of revenue-software licenses | \$ 1 | \$ 1 |
| Cost of revenue-services | 19 | 18 |
| Marketing and selling | 13 | 14 |
| Research and development | 79 | 63 |
| General and administrative | 82 | 59 |
| Share-based compensation expense before tax | 194 | 155 |
| Income tax benefit | | |
| Net compensation expense | \$ 194 | \$ 155 |

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BITSTREAM INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Commitments and Contingencies, (in thousands):

Lease commitments

We conduct our operations in leased facilities. In August 2003, we entered into a six-year lease agreement and moved our corporate offices. Our current lease agreement commenced on September 1, 2003 and obligated us to make minimum lease payments plus our pro-rata share of future real estate tax increases and certain operating expense increases above the base year. This lease agreement also required us to obtain a Letter of Credit in the amount of \$250, which resulted in \$250 in cash being classified as restricted on our Balance Sheet. The amount was reduced to \$200 on the second anniversary of the lease and further to \$150 on the fourth anniversary of the lease.

In July 2008, Bitstream India Pvt. Ltd., our wholly-owned subsidiary, entered into a 33 month lease agreement in Nodia India. This lease agreement commenced May 1, 2008 and obligated us to make monthly payments including service taxes. Our total financial commitment during the 33 month lease period is approximately \$132 U.S. dollars.

Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is primarily based on a dollar amount per unit shipped or a percentage of the underlying revenue. Royalty expense is recorded under our cost of software license revenue on our consolidated Statement of Operations.

Indemnification

We enter into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally business partners or customers, in connection with any U.S. patent, or any copyright or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual after execution of the agreement. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We have never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, we believe the estimated fair value of these agreements is minimal.

Legal Actions

From time to time we are subject to legal proceedings and claims in the ordinary course of business, including claims of infringement of third-party patents and other intellectual property rights, commercial, employment and other matters. We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. This provision is reviewed at least quarterly. As of March 31, 2009, no liability was recorded. Litigation is inherently unpredictable and it is possible that our financial position, cash flows, or results of operations could be materially affected in any particular period by the occurrence or resolution of any such contingencies or the costs involved in seeking the resolution of any such contingencies.

(5) Income Taxes (in thousands):

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under the liability method in accordance with SFAS No. 109, a deferred tax asset or liability is determined based on the difference between the financial statement and the tax basis of assets and liabilities, as measured by enacted tax rates in effect when these differences are expected to reverse.

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

The Company's income tax provisions for the three months ended March 31, 2009 and 2008 are primarily attributable to state income taxes in the U.S. and taxes related to foreign jurisdictions. Federal and state tax provisions for those periods included amounts in relation to the Company's income generated in the U.S., reduced by previously unused net operating loss (NOL) carry forwards and tax credits that were recorded on the balance sheet with a full valuation allowance. As of March 31, 2009, a full valuation allowance was recorded against the Company's net deferred tax assets in the U.S. At December 31, 2008, the Company had U.S. federal and state net operating loss (NOL) carryforwards of \$12,626 and \$59, respectively, of which the benefit of approximately \$7,532 and \$59, respectively, when realized, will be recorded as a credit to additional paid in capital. The Company's NOL carry-forwards begin to expire in 2020 for federal purposes. The Company also had U.S. federal and state research and development credit (R&D Credit) carryforwards of \$932 and \$331, respectively. These R&D credit carryforwards begin to expire in 2009 for federal purposes and 2016 for state purposes. As of December 31, 2008, we had foreign tax credit carryforwards of \$380. These foreign tax credit carryforwards begin to expire in 2012.

We continued to provide a full valuation allowance for our net deferred tax assets at March 31, 2009, as we believe it is more likely than not that the future tax benefits from accumulated net operating losses and deferred taxes will not be realized. We continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. However, it is possible that the more likely than not criterion could be met in future periods, which could result in the reversal of a significant portion or all of the valuation allowance, which, at that time, would be recorded as a tax benefit in the consolidated statement of operations.

Foreign taxes include foreign withholding taxes which vary with OEM license royalties from customers in countries who are a party to tax conventions with the United States including Korea, Israel and Poland, as well as, foreign taxes paid by Bitstream India Pvt. Ltd., our subsidiary, in India. The following is a summary of the components of the provision for income taxes:

| | Three Months Ended | |
|----------|--------------------|-------|
| | March 31, | |
| | 2009 | 2008 |
| Current: | | |
| State | | 14 |
| Foreign | 6 | 23 |
| Total | \$ 6 | \$ 37 |

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FAS 109* (FIN 48). This statement clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. The Company adopted FIN No. 48 on January 1, 2007. The implementation of FIN No. 48 did not have a material impact on the Company's consolidated financial statements, results of operations or cash flows. At the adoption date of January 1, 2007, and also at December 30, 2007, and December 31, 2008, the Company had no unrecognized tax benefits. The Company has not conducted a study of its research and development credit carryforwards. Such a study may result in an adjustment to the Company's research and development credit carryforwards; however, until a study is completed and any adjustment is known, no amounts are being presented as an uncertain tax position under FIN 48. A full valuation allowance has been provided against the Company's research and development credits and, if an adjustment is required, this adjustment would be offset by an adjustment to the valuation allowance. Thus, there would be no impact to the consolidated balance sheet or statement of operations if an adjustment were required.

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

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of March 31, 2009, we had no accrued interest or penalties related to uncertain tax positions. The tax years 2004 through 2008 remain open to examination by the major taxing jurisdictions to which we are subject. We have determined that it is more likely than not that the deferred tax assets will not be realized, therefore, a valuation allowance has reduced the deferred tax assets to zero.

(6) Geographical Reporting (in thousands):

SFAS 131, *Disclosures About Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments in annual financial statements and requires selected information of segments to be presented in financial reports issued to stockholders. Operating segments are defined as components of an enterprise about which separate financial information is available and that is evaluated regularly by the chief operating decision maker, or decision making group, in determining how to allocate resources and assess performance. Our chief operating decision maker, as defined under SFAS 131, is our chief executive officer. We view our operations and manage our business as one operating segment. Revenue by geography is based on the billing address of the customer. The following tables set forth revenue and long-lived assets by geographic area.

| | Three Months Ended March 31, | |
|--|---|--------------|
| | 2009 | 2008 |
| *Revenue: | | |
| United States | \$ 4,164 | \$ 5,431 |
| United Kingdom (UK) | 271 | 260 |
| Other (Countries less than 5% individually, by Region) | | |
| Europe, excluding UK | 334 | 262 |
| Asia | 101 | 247 |
| Other, including Canada | 131 | 169 |
| Total revenue | \$ 5,001 | \$ 6,369 |

-

* If revenue attributable to a specific country is greater than 5% in any period, revenue attributable to that country is disclosed for all periods. E-commerce credit card revenue is all included as attributable to the United States.

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

| | March 31, 2009 | December 31, 2008 |
|---------------|---------------------------|------------------------------|
| United States | \$ 348 | \$ 410 |
| India | 15 | 17 |
| Total | \$ 363 | \$ 427 |

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**PART I, ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

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

OVERVIEW

Bitstream Inc. was incorporated in the State of Delaware in 1981. Bitstream Inc. (together with its subsidiaries, Bitstream or the Company) is a software development company focused on bringing unique software products to a wide variety of markets. Today, our core software products include award-winning fonts and font rendering technologies, mobile browsing and messaging technologies and variable data publishing and Web-to-print technologies.

We maintain our executive offices at 245 First Street, 17th Floor, Cambridge, Massachusetts 02142-1270. Our telephone number is (617) 497-6222 and we maintain websites at www.bitstream.com, www.myfonts.com, and www.pageflex.com. Investors may obtain copies of our filings with the Securities and Exchange Commission (the SEC) free of charge from our website at www.bitstream.com or from the SEC's website at www.sec.gov.

CRITICAL ACCOUNTING POLICIES

We incorporate herein by reference the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operation Critical Accounting Policies contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and filed with the SEC on March 31, 2009. No changes have been made to those policies since December 31, 2008.

FORWARD LOOKING STATEMENTS

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These forward-looking statements generally are identified by the words believes, project, expects, anticipates, estimates, intends, strategy, plan, may, will, would, continue, will likely result, and similar expressions. 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 our 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 our filings with the SEC, including those risks and uncertainties discussed under the section entitled Forward Looking Statements contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 filed with the SEC on March 31, 2009. The forward-looking statements contained herein represent our judgment as of the date of this report, and we caution readers not to place undue reliance on such statements. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Table of Contents**RESULTS OF OPERATIONS (in thousands, except percentages and per share amounts)****Revenue and Gross Profit:**

| | Three Months Ended March 31, | | | | Change | |
|------------------------|------------------------------|--------------|-----------------|--------------|-----------------|----------------|
| | 2009 | % of Revenue | 2008 | % of Revenue | Dollars | Percent |
| Revenue | | | | | | |
| Software licenses | \$ 3,765 | 75.3% | \$ 5,126 | 80.5% | \$ (1,361) | (26.6)% |
| Services | 1,236 | 24.7 | 1,243 | 19.5 | (7) | (0.6) |
| Total revenue | 5,001 | 100.0 | 6,369 | 100.0 | (1,368) | (21.5) |
| Cost of Revenue | | | | | | |
| Software licenses | 1,565 | 41.6 | 2,014 | 39.3 | (449) | (22.3) |
| Services | 583 | 47.2 | 581 | 46.7 | 2 | 0.3 |
| Total cost of revenue | 2,148 | 43.0 | 2,595 | 40.7 | (447) | (17.2) |
| Gross Profit | \$ 2,853 | 57.0% | \$ 3,774 | 59.3% | \$ (921) | (24.4)% |

License revenue from direct sales, which includes e-commerce sales, decreased \$661, or 19.8%, to \$2,681 for the three months ended March 31, 2009 as compared to \$3,342 for the three months ended March 31, 2008. License revenue from resellers increased \$30, or 11.2%, to \$297 for the three months ended March 31, 2009 as compared to \$267 for the three months ended March 31, 2008. License revenue from OEMs and ISVs decreased \$730, or 48.1%, to \$787 for the three months ended March 31, 2009 as compared to \$1,517 for the three months ended March 31, 2008.

License revenue varies between quarters due to the timing of license agreements. Revenue for the three months ended March 31, 2009 decreased across all of our product lines due to delays in purchasing decisions by customers and decreases in royalties from consumer-based shipments by OEMs and ISVs during the quarter. We believe these decreases can be attributed primarily to the economic conditions affecting consumers during this period. If general economic conditions do not improve, license revenue for the year ending December 31, 2009 may continue to be lower than the level of license revenue achieved for the same periods in 2008.

The decrease in revenue from services was due to a decrease in consulting and training services of \$82, or 31.6% to \$177 for the three months ended March, 31 2009 as compared to \$259 for the three months ended March 31, 2008. This decrease was partially offset by increases in revenue related to support contracts primarily driven by increases in our customer base and customer demand for publishing support services, of \$75, or 7.6%, to \$1,059 for the three months ended March 31, 2009 as compared to \$984 for the three months ended March 31, 2008. We believe that our overall services revenue during 2009 will approximate the level attained in 2008 but if general economic conditions do not improve, service revenue for the year ending December 31, 2009 may continue to be lower than the level of service revenue achieved for the same periods in 2008.

We recognize license revenue from direct sales and from licensing our products and third party products including e-commerce sales made via our websites, from licensing agreements with OEMs and ISVs, and from the resale of our products through various resellers. We recognize reseller revenue if collection is probable, upon notification from the reseller that it has sold the product or, if for a physical product, upon delivery of the software. E-commerce sales include revenue from the licensing of Bitstream fonts and font technology, licensing of the ThunderHawk browser, licensing of fonts and font technology developed by third parties and from fees received from referring customers to other sites for which we have referral agreements. Referral income for the three months ended March 31, 2009 and 2008 was \$11 and \$6, respectively. There are minimal costs associated with referral revenue, and such costs primarily represent the time to load copies of the fonts provided by each participating foundry to the MyFonts.com database. We expense those costs as incurred.

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The decrease in cost of license revenue for the three-month period ended March 31, 2009 as compared to the three-month period ended March 31, 2008 was primarily due to a \$448 decrease in direct costs, including royalty costs, associated with decreased sales of third party products for the three months ended March 31, 2009. We expect the cost of license revenue as a percentage of license revenue for the fiscal year ending December 31, 2009 to approximate the percentage for the year ended December 31, 2008, although the results may vary based upon the mix of products sold during the remainder of the year.

Cost of services revenue for the three months ended March 31, 2009 approximated that for the three months ended March 31, 2008 as the personnel and services infrastructure remained materially unchanged. Total cost of services increased slightly as a percentage of services revenue for the three months ended March 31, 2009 as compared to the same period in 2008 due to the decrease in OEM and ISV consulting services discussed above. For the remainder of 2009, we expect our cost of services as a percentage of service revenue to approximate the percentages for 2008 but if economic conditions do not improve in 2009 these percentages may be higher without infrastructure changes being made.

Cost of revenue includes royalties and fees paid to third parties for the development of, or license of rights to, technology and/or unique typeface designs, costs incurred in the fulfillment of custom orders, costs incurred in providing customer support, maintenance, and training, and costs associated with the duplication, packaging and shipping of product.

Operating Expenses:

| | Three Months Ended March 31, | | | | Change | |
|----------------------------|------------------------------|--------------|----------|--------------|----------|---------|
| | 2009 | % of Revenue | 2008 | % of Revenue | Dollars | Percent |
| Marketing and selling | \$ 1,033 | 20.7% | \$ 1,135 | 17.8% | \$ (102) | (9.0)% |
| Research and development | 1,214 | 24.3 | 1,392 | 21.9 | (178) | (12.8) |
| General and administrative | 772 | 15.4 | 647 | 10.2 | 125 | 19.3 |
| Total operating expenses | \$ 3,019 | 60.4% | \$ 3,174 | 49.8% | \$ (155) | (4.9)% |

Marketing and selling (M&S) expense consists primarily of salaries and benefits, commissions, travel expense and facilities costs related to sales and marketing personnel, as well as marketing program-related costs including trade shows and advertising. The decrease in M&S expense for the three months ended March 31, 2009 as compared to the three months ended March 31, 2008 was primarily the result of a \$50 decrease in salaries & benefits, a \$40 decrease in professional services, and a \$25 decrease in advertising and marketing activities including tradeshow participation; partially offset by a \$12 increase in facilities and equipment costs. We expect our M&S expenses to continue at a similar level during the remainder of 2009.

Research and development (R&D) expense consists primarily of salary and benefits costs, contracted third-party development costs, and facility costs related to software developers and management. The decrease in R&D expense for the three months ended March 31, 2009 as compared to the three months ended March 31, 2008 was primarily the result of decreases in salaries and benefits and the use of third party contractors of \$198 partially offset by an increase in facilities and equipment costs of approximately \$18. We expect our development efforts to continue at a similar level during the remainder of 2009.

General and administrative (G&A) expense consists primarily of salaries, benefits, and other related costs including travel and facility expenses for finance, human resource, legal and executive personnel, legal and accounting professional services, provision for bad debts and director and officer insurance. The increase in G&A for the three months ended March 31, 2009 as compared to the three months ended March 31, 2008 is primarily due to an increase in bad debt expense of \$159 attributable to an increase in the allowance for doubtful accounts and an increase in professional fees of \$14, partially offset by decreases in administrative salaries and benefit costs of \$39 and in corporate insurance costs of \$8. We expect G&A expense to continue at a similar level during the remainder of 2009.

Table of Contents**Other Income, Net:**

| | Three Months Ended March 31, | | Three Months Ended March 31, | | Change | |
|--------------------------------|------------------------------|--------------|------------------------------|--------------|---------|---------|
| | 2009 | % of Revenue | 2008 | % of Revenue | Dollars | Percent |
| Interest and other income, net | \$ 19 | 0.4% | \$ 96 | 1.5% | \$ (77) | (80.2)% |

Other income includes interest income earned on cash and money market instruments and foreign currency transaction gains. Transaction gains for the three months ended March 31, 2009 and 2008 were \$14, and \$ 0, respectively. Net interest income has decreased as compared to the same periods in the prior year due to a lower rate of interest earned on our cash and money market instruments.

Provision for Income Taxes:

| | Three Months Ended March 31, | | Three Months Ended March 31, | | Change | |
|---|------------------------------|--------------|------------------------------|--------------|---------|---------|
| | 2009 | % of Revenue | 2008 | % of Revenue | Dollars | Percent |
| Provision for (benefit from) income taxes | \$ 6 | 0.1% | \$ 37 | 0.6% | \$ (31) | (83.8)% |

The Company's income tax provisions for the three months ended March 31, 2009 and 2008 are primarily attributable to state income taxes in the U.S. and taxes related to foreign jurisdictions. Federal and state tax provisions for those periods included amounts in relation to the Company's income generated in the U.S., reduced by previously unused net operating loss (NOL) carry forwards and tax credits that were recorded on the balance sheet with a full valuation allowance. As of March 31, 2009, a full valuation allowance was recorded against the Company's net deferred tax assets in the U.S. At December 31, 2008, the Company had U.S. federal and state net operating loss (NOL) carryforwards of \$12,626 and \$59, respectively, of which the benefit of approximately \$7,532 and \$59, respectively, when realized, will be recorded as a credit to additional paid in capital. The Company's NOL carry-forwards begin to expire in 2020 for federal purposes. The Company also had U.S. federal and state research and development credit (R&D Credit) carryforwards of \$932 and \$331, respectively. These R&D credit carryforwards begin to expire in 2009 for federal purposes and 2016 for state purposes. As of December 31, 2008, we have foreign tax credit carryforwards of \$380. These foreign tax credit carryforwards begin to expire in 2012.

We continued to provide a full valuation allowance for our net deferred tax assets at September 30, 2008, as we believe it is more likely than not that the future tax benefits from accumulated net operating losses and deferred taxes will not be realized. We continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. However, it is possible that the more likely than not criterion could be met in future periods, which could result in the reversal of a significant portion or all of the valuation allowance, which, at that time, would be recorded as a tax benefit in the consolidated statement of operations.

Foreign taxes include foreign withholding taxes which vary with OEM license royalties from customers in countries who are a party to tax conventions with the United States including Korea, Israel and Poland, as well as, foreign taxes paid by Bitstream India Pvt. Ltd., our subsidiary, in India.

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LIQUIDITY AND CAPITAL RESOURCES (in thousands, except share and per share amounts)

The Company has funded its operations primarily through the public sale of equity securities, cash flows from operations, cash received from the sale of our MediaBank and InterSep OPI product lines to Inso Providence Corporation in August of 1998, and cash received from the sale of our investment in DiamondSoft to Extensis in July of 2003. As of March 31, 2009, we had net working capital of \$14,771 versus \$14,257 at December 31, 2008, an increase of \$514 or 4%.

Our operating activities generated cash during the three months ended March 31, 2009 and 2008 of \$491 and \$750, respectively. Cash from operating activities was generated primarily from the collections of receivables which decreased by \$752 for the three months ended March 31, 2009 partially offset by a net increase in payables and accruals during the same period. Cash from operating activities was generated for the three months ended March 31, 2008 primarily due to our net income before adjustment for non-cash expenses of \$659. We used cash of \$8 and \$60 for the three months ended March 31, 2009 and 2008, respectively, for the purpose of acquiring additional property and equipment and intangible assets. Our financing activities for the three months ended March 31, 2009 provided cash of \$411 from the exercise of stock options, while our financing activities for the three months ended March 31, 2008 used cash of \$1,769 to repurchase shares of our common stock which was partially offset by \$114 in proceeds from the exercise of stock options. Our cash balance also increased by \$1 from the effect of foreign currency exchange rates applied to the balances and activities of our subsidiary, Bitstream India Pvt. Ltd, whose functional currency is the Indian Rupee.

As of March 31, 2009, we had no material commitments for capital expenditures.

In August 2003, we entered into a six-year lease agreement and moved our corporate offices. Our current lease expires August 31, 2009 and we are currently reviewing our options for renewing the current lease or obtaining other suitable office space. We understand that sufficient office space is currently available in our geographic area and that, given general economic conditions, we will be able to secure the amount of space we need to conduct our operations at reasonable market rates.

We believe our current cash and cash equivalent balances will be sufficient to meet our operating and capital requirements for at least the next 12 months. There can be no assurance, however, that we will not require additional financing in the future. If we were required to obtain additional financing in the future, there can be no assurance that sources of capital would be available on terms favorable to us, if at all.

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is primarily based on a dollar amount per unit shipped or a percentage of the underlying revenue. Royalty expense is recorded as cost of license revenue on our Consolidated Statement of Operations.

Off-Balance Sheet Arrangements

We enter into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally business partners or customers, in connection with any U.S. patent, or any copyright or other intellectual property infringement claim by any third party with respect to our products. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We have never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, we believe the estimated fair value of these agreements is minimal, but we can provide no assurance that payments will not be required under these agreements in the future.

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RECENT ACCOUNTING PRONOUNCEMENTS

On January 1, 2009, we adopted FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per share. FSP EITF 03-6-1 is effective in 2009. The adoption of EITF 03-6-1 has not had a material impact on our consolidated financial statements.

On January 1, 2009, we adopted FASB Staff Position (FSP) 157-2. *Effective date of FASB No. 157, FSP 157-2 delayed the effective date of SFAS 157, Fair Value Measurements* (SFAS 157) for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. The adoption of FSP 157-2 on January 1, 2009 did not have a material impact on our consolidated financial statements.

On January 1, 2009, SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R) became effective for us. This statement significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in process research and development, and restructuring costs. In addition, under this statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS 141R may have a material impact on our consolidated financial statements if or when we enter into a business combination.

On January 1, 2009, SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements* , an amendment of ARB No. 51 became effective for us. This statement changes the accounting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method significantly changes the accounting for transactions with minority interest holders. As of March 31, 2009, the Company did not have any minority interests.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* . This FSP amends SFAS 107, *Disclosure about Fair Value of Financial Instruments* , to require disclosures about fair value of financial instruments in interim as well as annual financial statements. This FSP also amends APB 28, *Interim Financial Reporting* , to require those disclosures in all interim financial statements. This standard is effective for periods ending after June 15, 2009. We are currently evaluating the impact that this standard may have on our financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FSP FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* , which amends the other-than-temporary impairment guidance for debt and equity securities. This standard is effective for periods ending after June 15, 2009. We currently anticipate that the adoption of FSP FAS 115-2 and FSP FAS 124-2 will not have an impact on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments.

As of March 31, 2009, we 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 our investments are short-term money market accounts and bank deposits that are carried on our books at fair market value. Accordingly, we have no quantitative information concerning the market risk of participating in such investments.

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Primary Market Risk Exposures

Our primary market risk exposures are in the areas of interest rate risk and foreign currency exchange rate risk. Our investment portfolio of cash equivalent and short-term investments is subject to interest rate fluctuations, but we believe this risk is immaterial due to the short-term nature of these investments. Our exposure to currency exchange rate fluctuations has been and is expected to continue to be modest due to the fact that the operations of our international subsidiary are almost exclusively conducted in the local currency. The impact of currency exchange rate movements on inter-company transactions was immaterial for the three months ended March 31, 2009. International subsidiary operations will be translated into U.S. dollars and consolidated for reporting purposes. Currently, we do not engage in foreign currency hedging activities.

ITEM 4. CONTROLS AND PROCEDURES

Management's evaluation of our disclosure controls and procedures.

Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures, (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), with the participation of our management, have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective and were designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. It should be noted that any system of controls is designed to provide reasonable, but not absolute, assurances that the system will achieve its stated goals under reasonably foreseeable future circumstances. Our principal executive officer and principal financial officer have concluded that, as of such date, the Company's disclosure controls and procedures are effective at a level that provides such reasonable assurances.

Changes in internal control over financial reporting.

There was no change in our internal control over financial reporting that occurred during the quarter ended March 31, 2009 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time we are subject to legal proceedings and claims in the ordinary course of business, including claims of infringement of third-party patents and other intellectual property rights, and claims involving commercial, employment and other matters. We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. This provision is reviewed at least quarterly. As of March 31, 2009, no liability was recorded. Litigation is inherently unpredictable and it is possible that our financial position, cash flows, or results of operations could be materially affected in any particular period by the resolution of any such contingencies or the costs involved in seeking the resolution of any such contingencies.

ITEM 1A. RISK FACTORS

We incorporate herein by reference the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operation Risk Factors" contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and filed with the SEC on March 31, 2009. There have not been any material changes in the risk factors previously disclosed in our Annual Report on Form 10-K.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Instruments defining the rights of the holders of any class of our registered securities have not been materially modified during the three months ended March 31, 2009.
- (b) Rights evidenced by any class of our registered securities have not been materially limited or qualified by the issuance or modification of any other class of securities during the three months ended March 31, 2009.
- (c) There were no unregistered securities sold by us during the three months ended March 31, 2009.
- (d) There were no repurchases of our equity securities during the three months ended March 31, 2009.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

NONE

ITEM 5. OTHER INFORMATION

- (a) Consistent with Section 10A(i)(2) of the Exchange Act, as added by Section 202 of Sarbanes-Oxley, the Company is responsible for listing the non-audit services approved during any reporting period by its Audit Committee to be performed by PricewaterhouseCoopers LLP, the Company's external auditor. During the three months ended March 31, 2009, the Audit Committee approved the following amounts for services:

| | |
|--|------------------|
| Audit fees for year ending December 31, 2008 | \$ 20,000 |
| Tax services including planning | 47,750 |
| Total approved | \$ 67,750 |

- (b) During the three months ended March 31, 2009, there were no changes made to the procedures by which security holders may recommend nominees to the Company's Board of Directors.

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ITEM 6. EXHIBITS

(a) Exhibits

CERTIFICATIONS

- 31.1 Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

PART II SIGNATURES

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 and Chief Executive Officer (Principal Executive Officer) | May 15, 2009 |
| /s/ James P. Dore James P. Dore | Vice President and Chief Financial Officer (Principal Financial Officer) | May 15, 2009 |