ACTUATE CORP
Form 10-Q
November 06, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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 No. 0-24607

Actuate Corporation

(Exact name of Registrant as specified in its charter)

Delaware	**94-3193197**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

2207 Bridgepointe Parkway, Suite 500

San Mateo, California 94404

(650) 645-3000

(including area code, of Registrant s principal executive offices)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 x

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

Title of Class	**Outstanding as of September 30, 2009**
Common Stock, par value $.001 per share	45,394,709

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Actuate Corporation

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PART I FINANCIAL INFORMATION

PART II OTHER INFORMATION

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Part I. Financial Information

Item 1. Financial Statements

ACTUATE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands except share and per share data)

(unaudited)

	September 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,029	$ 24,772
Short-term investments	42,245	17,278
Accounts receivable, net of allowance of $710 and $606 at September 30, 2009 and December 31, 2008, respectively	20,368	28,017
Other current assets	7,982	6,620
Total current assets	98,624	76,687
Property and equipment, net	4,135	4,729
Goodwill	36,114	36,114
Other purchased intangibles, net	1,125	1,800
Non-current deferred tax assets	13,047	12,602
Non-current investments		16,391
Other assets	1,782	2,189
	$ 154,827	$ 150,512
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 819	$ 2,067
Restructuring liabilities	2,774	3,206
Accrued compensation	4,349	4,514
Other accrued liabilities	5,158	5,299
Deferred revenue	35,937	40,900
Total current liabilities	49,037	55,986
Long-term liabilities:		
Note payable	30,000	30,000
Other liabilities	852	1,054
Long-term deferred revenue	1,614	2,472
Long term income tax payable	776	1,660
Restructuring liabilities, less current portion	884	3,092
Total long-term liabilities	34,126	38,278
Non-controlling interest in subsidiary	633	584

Stockholders equity:		
Preferred stock, $0.001 par value, issuable in series: 5,000,000 shares authorized; none issued and outstanding		
Common stock, $0.001 par value, 100,000,000 shares authorized; issued 78,503,314 and 75,514,061 shares, respectively; outstanding 45,394,709 and 44,169,649 shares, respectively	45	44
Additional paid-in capital	176,510	160,619
Treasury stock, at cost 33,108,605 shares and 31,344,412, respectively	(127,338)	(117,256)
Accumulated other comprehensive loss	(72)	(887)
Retained earnings	21,886	13,144
Total stockholders equity	71,031	55,664
	$ 154,827	$ 150,512

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

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ACTUATE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenues:				
License fees	$ 8,620	$ 10,021	$ 25,907	$ 29,920
Maintenance	19,340	20,406	56,889	56,791
Professional Services	1,391	3,254	5,352	11,091
Total revenues	29,351	33,681	88,148	97,802
Costs and expenses:				
Cost of license fees	267	350	703	1,066
Cost of services	4,185	5,299	13,718	17,861
Sales and marketing	10,231	13,168	31,433	39,982
Research and development	4,998	5,459	15,256	16,860
General and administrative	5,085	5,053	14,717	14,457
Amortization of other purchased intangibles	170	237	510	711
Restructuring charges	129	672	240	1,075
Total costs and expenses	25,065	30,238	76,577	92,012
Income from operations	4,286	3,443	11,571	5,790
Interest income and other income/(expense), net	(405)	686	179	764
Interest expense	(347)	(3)	(1,057)	(3)
Income before income taxes	3,534	4,126	10,693	6,551
Provision (benefit) for income taxes	395	1,021	1,951	(2,356)
Net income	$ 3,139	$ 3,105	$ 8,742	$ 8,907
Basic net income per share	$ 0.07	$ 0.05	$ 0.19	$ 0.15
Shares used in basic per share calculation	45,580	60,387	45,026	60,505
Diluted net income per share	$ 0.06	$ 0.05	$ 0.18	$ 0.13
Shares used in diluted per share calculation	50,484	65,397	49,235	66,075

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

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ACTUATE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Nine Months Ended September 30, 2009	2008
Operating activities		
Net income	$ 8,742	$ 8,907
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation expense related to stock options and employee stock purchase plan	5,367	7,091
Amortization of other purchased intangibles	675	1,146
Amortization of debt issuance cost	210	
Depreciation	1,643	1,740
Net operating loss utilizations (adjustments) related to prior acquisitions		(228)
Change in valuation allowance on deferred tax assets	(575)	85
Accretion/amortization on short-term debt securities	118	218
Loss/(gain) on Auction Rate Securities (ARS)	(678)	
Loss on the fair value of put option	607	
Changes in operating assets and liabilities:		
Accounts receivable, net of allowance	7,649	16,393
Other current assets	(314)	829
Accounts payable	(1,248)	(1,167)
Accrued compensation	(165)	(2,170)
Other accrued liabilities	131	(1,654)
Deferred tax assets	115	51
Income taxes receivable	(1,044)	(2,206)
Income taxes payable	(884)	
Other liabilities	(202)	(124)
Restructuring liabilities	(2,640)	(1,817)
Deferred revenue	(5,821)	(2,649)
Net cash provided by operating activities	11,686	24,445
Investing activities		
Purchases of property and equipment	(1,048)	(1,672)
Release of restricted cash	229	
Proceeds from sale and maturity of investments	13,706	53,418
Purchases of short-term investments	(22,243)	(43,385)
Change in other current and non-current assets	(61)	
Net cash provided by (used in) investing activities	(9,417)	8,361
Financing activities		
Tax benefit from exercise of stock options	2,649	
Proceeds from issuance of common stock	7,906	4,932
Stock repurchases	(10,297)	(12,675)
Net cash provided by (used in) financing activities	258	(7,743)
Net increase in cash and cash equivalents	2,527	25,063
Effect of exchange rates on cash and cash equivalents	730	(497)

Cash and cash equivalents at the beginning of the period	24,772	21,468
Cash and cash equivalents at the end of the period	$ 28,029	$ 46,034

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

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ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Actuate and its wholly-owned and majority-owned subsidiaries. Actuate has offices throughout North America, Europe and Asia including offices in the United States, Canada, Switzerland, United Kingdom, Germany, France, Singapore, Japan and China. All intercompany balances and transactions have been eliminated.

As of September 30, 2009, Actuate owns approximately 88% of the outstanding voting stock of Actuate Japan Company Ltd. (Actuate Japan). The Company has consolidated the results of Actuate Japan from the date that it became the majority shareholder, which occurred in fiscal year 2000. During the first quarter of fiscal 2009, we adopted new accounting guidance for noncontrolling interests in subsidiaries as issued by the Financial Accounting Standards Board (FASB). The new accounting guidance establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as a minority interest, is a third-party ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, the new guidance requires the consolidated statement of income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. The new guidance also requires disclosure on the face of the consolidated statement of income of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. The adoption of this accounting guidance did not have a material impact on our consolidated financial statements.

Actuate Japan s financial results are reflected in each revenue, cost of revenue and expense category in the consolidated statement of operations. Through September 30, 2009, the operating performance and liquidity requirements of Actuate Japan had not been material to the Company s results of operations or financial condition. Although the Company plans to maintain and expand selling and marketing activities in Japan to add new customers, the future liquidity requirements of Actuate Japan are not expected to be significant.

During the second quarter of 2009, we adopted new accounting guidance related to subsequent events as issued by the FASB. The new requirement establishes the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. The Company has evaluated subsequent events through November 6, 2009, the issuance date of the financial statements for the three months ended September 30, 2009.

Revenue Recognition

Actuate generates revenues from the sales of software licenses and related services. The Company receives software license revenues from licensing its products directly to end-users and indirectly through resellers, system integrators and original equipment manufacturers (OEMs). The Company receives service revenues from maintenance contracts, consulting services and training that Actuate performs for customers.

Actuate recognizes revenues in accordance with authoritative guidance issued by the American Institute of Certified Public Accountants (AICPA) on revenue recognition. For sales to end-user customers, Actuate recognizes license revenues when a license agreement has been signed by both parties or a definitive agreement has been received from the customer, the product has been physically shipped or electronically made available, there are no unusual uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence of fair value of sales to end users is based on the price charged when an element is sold separately. Actuate has not established vendor-specific objective evidence of fair value for its licenses. Therefore, the Company recognizes revenues from arrangements with multiple elements involving software licenses under the residual method which means the full fair value is allocated to the undelivered elements while the remaining value of the arrangement is allocated to the delivered elements. If the license agreement contains payment terms that would indicate that the fee is not fixed or determinable, revenues are recognized as the payments become due and payable, assuming that all other revenue recognition criteria are met.

Actuate enters into reseller and distributor arrangements that typically give such distributors and resellers the right to distribute its products to end-users headquartered in specified territories. Actuate recognizes license revenues from arrangements with U.S. resellers and distributors when there is persuasive evidence of an arrangement with the reseller or distributor, the product has been shipped, the fees are fixed or determinable, and collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Actuate recognizes license revenues from arrangements with

international resellers and distributors upon receipt of evidence of sell-through and when all other revenue recognition criteria have been met. If it is not practical to obtain evidence of sell-through, the Company defers revenues until the end-user has been identified and cash has been received. In some instances there is a timing difference between when a reseller completes its sale to the end-user

ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

and the period in which Actuate receives the documentation required for revenue recognition. Because Actuate delays revenue recognition until the reporting period in which the required documentation is obtained, it may recognize revenue in a period subsequent to the period in which the reseller completes the sale to its end-user.

Actuate also enters into OEM arrangements that provide for license fees based on the bundling or embedding of its products with the OEM s products. These arrangements generally provide for fixed, irrevocable royalty payments. Actuate recognizes license fee revenues from U.S. and international OEM arrangements when a license agreement has been executed by both parties, the product has been shipped, there are no unusual uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement.

The Company typically establishes vendor specific objective evidence of fair value under a bell-shaped curve approach. However, for certain types of license transactions, including OEM and site license, the Company uses a stated maintenance renewal approach.

Credit-worthiness and collectibility for end-users are assessed based on payment history and current credit profile. When a customer is not deemed credit-worthy, revenues are deferred and recognized upon cash receipt.

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

A significant portion of our revenues have historically been derived from customers in the financial services industry. The Company expects that it will continue to derive a significant portion of its revenues from these financial services customers for the foreseeable future. Unfavorable economic conditions have adversely impacted the financial services industry throughout fiscal 2008 and the first nine months of fiscal 2009. If this trend continues, it will likely have a material adverse effect on the Company s business, financial condition and results of operations.

Share-Based Compensation

The Company has various types of share-based compensation plans. These plans are administered by the compensation committee of the Board of Directors, which selects persons to receive awards and determines the number of shares subject to each award and the terms, conditions, performance measures and other provisions of the award. Readers should refer to Note 9 of the Company s consolidated financial statements in the Annual Report on Form 10-K for the fiscal year ended December 31, 2008, for additional information related to these share-based compensation plans. Share-based compensation expense and the related income tax benefit in the Condensed Consolidated Statements of Income in connection with stock options and the Employee Stock Purchase Plan (ESPP) for the three and nine months ended September 30, 2009 and 2008 were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2009	**September 30, 2008**	**September 30, 2009**	**September 30, 2008**
Stock Options	$ 1,320	$ 1,820	$ 4,448	$ 6,307
ESPP	284	260	919	784
Total stock-based compensation	$ 1,604	$ 2,080	$ 5,367	$ 7,091

Income tax benefit	$ 1,429	$	$ 2,649	$

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option pricing model. We estimated the expected term of options granted by analyzing actual historical experience of exercises and cancellations under our plan. We also looked at the average length of time in which our current outstanding options are expected to be exercised or cancelled based on past experience and the vesting and contractual term. We estimated the volatility of our common stock by using historical volatility over the calculated expected term. We based the risk-free interest rate that we use in the option valuation model on the published Treasury rate. We do not anticipate paying any cash dividends in the foreseeable future and therefore used an expected dividend yield of zero in the option valuation model. The assumptions used to estimate the fair value of stock options granted and stock purchase rights granted under our ESPP Plan for the nine months ended September 30, 2009 and 2008 are as follows:

	Options Nine Months Ended		**ESPP Nine Months Ended**	
	September 30, 2009	**September 30, 2008**	**September 30, 2009**	**September 30, 2008**
Volatility	57.16 59.03%	59.08 71.49%	69.17 94.69%	43.13 55.79%
Expected term (years)	5.49 5.55	5.55 5.70	0.5	0.5
Risk free interest rate	1.75 2.625%	2.50 3.50%	0.46 0.62%	2.05 2.18%
Expected dividend yield	0%	0%	0%	0%
Annual forfeiture rate	3 4%	3%	N/A	N/A

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ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In February 2009, the Company granted additional stock options totaling 400,000 shares to its President and Chief Executive Officer (CEO), Mr. Peter Cittadini and 40,000 shares to its Senior Vice President and Chief Financial Officer (CFO), Mr. Daniel Gaudreau. These grants have a shorter term life and therefore require a separate set of assumptions for valuation purposes. For the first quarter of fiscal 2009, the assumptions used for volatility, expected term, risk free interest rate and expected dividend yield were 59.66%, 3.58 years, 1.375% and 0%, respectively.

Net Income Per Share

Basic net income per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income per share is computed using the weighted-average number of common and dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of the shares issuable upon the exercise of stock options using the treasury stock method. ESPP shares were not included in the calculation of the common equivalent shares for the periods presented as the impact of these shares in the weighted share calculations were immaterial.

The table below reconciles the weighted average common shares used to calculate basic net income per share with the weighted-average common shares used to calculate diluted net income per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Weighted-average common shares outstanding	45,580	60,387	45,026	60,505
Weighted-average dilutive stock options outstanding under the treasury stock method	4,904	5,010	4,209	5,570
Weighted-average common shares used in computing diluted net income per share	50,484	65,397	49,235	66,075

Under the treasury stock method, stock options with exercise prices exceeding the average share price of the Company s common stock during the applicable period are excluded from the diluted earnings per share computation. The weighted-average number of shares excluded from the calculation of diluted net income was 3,124,635 and 7,600,668 in the three and nine months ended September 30, 2009, respectively. In the three and nine months ended in September 30, 2008, the Company excluded 6,593,990 and 5,883,518 stock options from its calculation of weighted-average common shares used in computing dilutive net income per share. Such stock options, had they been dilutive, would have been included in the computation of diluted net income per share.

The weighted average exercise price of excluded stock options was $7.23 and $5.56 for the three and nine months ended September 30, 2009, respectively. The weighted average exercise price of excluded stock options was $6.08 and $6.26 for the three and nine months ended September 30, 2008, respectively.

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ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Income Taxes

At the end of each interim period, the Company estimates the annual effective tax rate and applies that rate to its ordinary quarterly earnings. The tax expense or benefit related to significant, unusual, or extraordinary items that will be separately reported or reported net of their related tax effect, are recognized as discreet items in the interim period in which those items occur. This includes changes in judgment about valuation allowances and the effect of changes in enacted tax laws or rates or tax status.

The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in foreign jurisdictions, permanent and temporary differences, and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, more experience is acquired, additional information is obtained or as the tax environment changes.

The Company recognizes and measures uncertain tax positions and only recognizes the tax benefit from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Comprehensive Income

Other comprehensive income includes currency translation adjustments and unrealized gains (losses) on investments that are not included in net income, but rather are recorded directly in stockholders equity. Comprehensive income during the three and nine months of fiscal 2009 and 2008 was comprised of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Net income	$ 3,139	$ 3,105	$ 8,742	$ 8,907
Foreign currency translation gain (loss)	664	(1,669)	730	(497)
Unrealized gain (loss) on investments	10	(486)	85	(1,425)
Total comprehensive income	$ 3,813	$ 950	$ 9,557	$ 6,985

Summary of Significant Accounting Policies

The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP). In management s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its financial position, results of operations and cash flows. The Company s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in Actuate s Annual Report on Form 10-K for the fiscal year ended December 31, 2008 filed with the SEC on March 12, 2009.

To prepare financial statements in conformity with GAAP, management must make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ from these estimates and may result in material effects on the Company s operating results and financial position.

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ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Recent Accounting Pronouncements

During the third quarter of 2009, we adopted the new Accounting Standards Codification (ASC) as issued by the Financial Accounting Standards Board (FASB). The ASC has become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. The ASC is not intended to change or alter existing GAAP. The adoption of the ASC did not have a material impact on our consolidated financial statements.

In August 2009, the FASB issued new accounting guidance related to the measurement and disclosure of liabilities at fair value. This update provides clarification for the fair value measurement of liabilities in circumstances in which a quoted price in an active market for an identical liability is not available. This update is effective for interim periods beginning after August 28, 2009. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

In June 2009, the FASB issued new accounting guidance which amends the evaluation criteria to identify the primary beneficiary of a variable interest entity (VIE) and requires ongoing reassessment of whether an enterprise is the primary beneficiary of the VIE. The new guidance significantly changes the consolidation rules for VIEs including the consolidation of common structures, such as joint ventures, equity method investments and collaboration arrangements. The guidance is applicable to all new and existing VIEs. The provisions of this new accounting guidance is effective for interim and annual reporting periods ending after November 15, 2009 and will become effective for us beginning in the first quarter of 2010. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

During the second quarter of 2009, we adopted three related standards of accounting guidance as issued by the FASB. The accounting guidance sets forth rules related to determining the fair value of financial assets and financial liabilities when the activity levels have significantly decreased in relation to the normal market, guidance related to the determination of other-than-temporary impairments and interim disclosure requirements for the fair value of financial instruments. The adoption of the three standards of accounting guidance did not have a material impact on our consolidated financial statements.

On January 1, 2009, we adopted new accounting guidance for business combinations as issued by the FASB. The new accounting guidance establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree, as well as the goodwill acquired. Significant changes from previous guidance resulting from this new guidance include the expansion of the definitions of a business and a business combination. For all business combinations (whether partial, full or step acquisitions), the acquirer will record 100% of all assets and liabilities of the acquired business, including goodwill, generally at their fair values. Contingent consideration will be recognized at its fair value on the acquisition date. For certain arrangements, changes in fair value will be recognized in earnings until settlement, and acquisition-related transaction and restructuring costs will be expensed rather than treated as part of the cost of the acquisition. The new accounting guidance also establishes disclosure requirements to enable users to evaluate the nature and financial effects of the business combination. The adoption of this accounting guidance did not have a material impact on our consolidated financial statements.

On January 1, 2009, we adopted new accounting guidance for the determination of the useful life of intangible assets as issued by the FASB. The new guidance amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The new guidance also requires expanded disclosure regarding the determination of intangible asset useful lives. The adoption of this accounting guidance did not have a material impact on our consolidated financial statements.

2. Investment in Actuate Japan

Noncontrolling (minority) Interest - The minority shareholder of Actuate Japan has a non-expiring option to put its equity interest (non-controlling interest) in Actuate Japan to the Company and the Company has the option to call the non-controlling interest. The redeemable non-controlling interest as of September 30, 2009 was approximately 12% of the total equity interest. If the non-controlling interest shareholder chose to put these remaining shares to the Company, Actuate would be required to pay approximately $633,000 to purchase these shares. The

Company measures and discloses a redeemable non-controlling interest in accordance with the policy discussed above at the calculated redemption value of the put option embedded in the non-controlling interest. The non-controlling shareholder is also a distributor of Actuate products in Japan, although the volume of revenues sold through this distributor has historically been immaterial to Actuate Corporation. The Company consolidated 100% of the operating results of Actuate Japan and all investments in the subsidiary are eliminated in consolidation. Through September 30, 2009, the operating performance and liquidity requirements of Actuate Japan had not been material to the Company s results of operations or financial condition. Although the Company plans to maintain and expand its selling and marketing activities in Japan to add new customers, the future liquidity requirements of Actuate Japan is not expected to be significant in the near future. As of the date of this filing, the remaining non-controlling shareholder has not notified the Company of any intent to exercise its put option.

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ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

3. Fair Value Measurements of Financial Assets and Liabilities

In April 2009, the FASB issued new accounting guidance related to interim disclosures about the fair values of financial instruments. This guidance requires disclosures about the fair value of financial instruments whenever a public company issues financial information for interim reporting periods. For certain of our financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, accounts payable, and other current liabilities the carrying amounts approximate their fair value due to the relatively short maturity of these balances. We also believe that the carrying value of our note payable approximates fair value as it s been less than one year since we have entered into this Credit Agreement and that the interest rate on this note is based on a floating market rate. The Company adopted this guidance during the second quarter of fiscal 2009.

The Company has investments that are valued in accordance with the provisions of the authoritative guidance that addresses fair value measurements. This guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets that the Company has the ability to access.

Level 2 Valuations based inputs on other than quoted prices included within level 1, for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The following table represents information about the Company s investments measured at fair value on a recurring basis (in thousands):

	Fair value of investments as of September 30, 2009			
	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$ 4,971	$ 4,971	$	$
Term deposits	10,607	10,607		
Commercial paper	8,995		8,995	
Corporate bonds	12,575		12,575	
Federal and municipal obligations	4,213		4,213	
Auction Rate Securities (ARS)	14,560			14,560
Put option	1,902			1,902
	$ 57,823	$ 15,578	$ 25,783	$ 16,462

Certain items in the table above are classified as Level 2 items because quoted prices in an active market are not readily accessible for those specific financial assets, and the Company may have relied on alternative pricing methods that do not rely exclusively on quoted prices to determine the fair value of the investments.

Our investment portfolio includes Auction Rate Securities (ARS) which are investments with contractual maturities. They are usually found in the form of municipal bonds, a pool of student loans or collateralized debt obligations whose interest rates are subject to reset through an auction process. The ARS held by us are primarily backed by highly rated municipal issuers.

As of September 30, 2009, the Company had approximately $16.4 million in ARS at par value. Since February 2008, substantially all auctions for ARS have failed as a result of the negative overall capital market conditions, meaning that there is not enough demand to sell the securities at auction. While the Company continues to earn interest on its ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value.

In November 2008, the Company elected to participate in a rights offering by UBS, the Company s investment broker, which provides Actuate with rights (the Put Option) to sell UBS its ARS portfolio at the $16.4 million par value, at any time during a two-year sale period beginning June 30, 2010. By electing to participate in the rights offering, the Company granted UBS the right, exercisable at any time prior to June 30, 2010 or during the two-year sale period, to purchase or cause the sale of our ARS (the Call Right). UBS has stated that it will only exercise the Call Right for the purpose of restructurings, dispositions or other solutions that will provide their clients with par value for their ARS. UBS has agreed to pay their clients the par value of their ARS within one day of settlement of any Call Right transaction. Notwithstanding the Call Right, the Company is permitted to sell ARS to parties other than UBS, in which case the Put Option attached to the ARS that are sold would be extinguished. At September 30, 2009, the Company has valued the Put Option at the approximate present value of the difference between the fair market value and the par value of the ARS.

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ACTUATE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

At September 30, 2009, the Company has classified the ARS and the related Put Option as current investments on its Consolidated Balance Sheet. This classification was based on the intent and ability of the Company to sell the ARS back to UBS as soon as the Put Option allows, which is currently expected to be June 30, 2010.

The Company has no reason to believe that any of the underlying issuers of its ARS are presently at risk of default. Through September 30, 2009, the Company has continued to receive interest payments on the ARS in accordance with their terms. Currently, interest is being earned at the maximum contractual rate, which may not exceed the one year trailing average rate on the three month Treasury Bill plus 120 basis points. The Company believes that it will ultimately be able to liquidate its ARS related investments without significant loss primarily due to the collateral securing the ARS and the legal settlement it has entered into with UBS. However, it could take until final maturity of the ARS (up to 38 years) to realize the investments par value.

The estimated fair value of ARS no longer approximates par value. The Company has used a discounted cash flow model to determine the estimated fair value of its investment in ARS as of September 30, 2009. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. Based on this assessment of fair value, as of September 30, 2009 the Company determined there was a decline in the fair value of its ARS investments of approximately $2.6 million in fiscal 2008, and approximately $678,000 improvement in the fair value of the ARS during the first nine months of fiscal 2009. Therefore, the cumulative net impairment of the ARS investments totaled approximately $1.9 million as of September 30, 2009. This determination was largely based on the fact that the Company reclassified the ARS investments from available for sale to trading status. This reclassification was based on the fact that Actuate fully intends to sell the ARS as soon as the Put Option settlement agreement allows. An other-than-temporary impairment charge is recorded as a realized loss in the Consolidated Statement of Income and reduces net income for the applicable accounting period. Prior to the quarter ended December 31, 2008, the ARS were classified as available-for-sale and all temporary changes in fair value were recognized in Accumulated Other Comprehensive Income (Loss) on the Company s Consolidated Balance Sheet.

The authoritative guidance issued by the FASB on accounting for and presenting impairment losses on securities are effective for Actuate beginning with the second quarter of fiscal 2009. However, the impact on Actuate this quarter is not significant.

In the second quarter of 2009, the FASB issued the authoritative guidance on determining fair value when market activity has decreased. This guidance was effective for Actuate beginning with the second quarter of fiscal 2009. The value of our non-ARS investments that are valued using Level 2 inputs are based on a quoted price from a market that has not experienced a significant decrease in activity. Therefore, the Company will continue using Level 2 inputs from orderly transaction in our fair value measurement of the Level 2 assets.

The following table represents the reconciliation of the beginning and ending balances of the Company s ARS and Put Option measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the first nine months of fiscal year 2009 (in thousands).

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) ARS and Put option
Balance at December 31, 2008	$ 16,391
Recorded net gain on ARS included in earnings	678
Net loss on fair value of Put option included in earnings	(607)

Balance at September 30, 2009	$	16,462

The Company s cash, cash equivalents, short-term investments and non-current investments are as follows (in thousands):

	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Realized Changes in fair value	Estimated Fair Value
Balance at September 30, 2009					
Classified as cash and cash equivalents:					
Cash	$ 12,451	$	$	$	$ 12,451
Term deposits	10,607				10,607
Money market funds	4,971				4,971
	28,029				28,029
Classified as short-term investments:					
Commercial paper	8,996		(1)		8,995
Corporate bonds	12,462	115	(2)		12,575