UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2003

or

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

For the transition period from to

COMMISSION FILE NUMBER: 0-21541

BITSTREAM INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-2744890**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

245 First Street, 17th Floor, Cambridge, Massachusetts 02142-1270

(Address of principal executive offices)

Registrant s telephone number, including area code: (617) 497-6222

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Class A Common Stock

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by a check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ¨ No x

The aggregate market value of voting stock held by non-affiliates of the Registrant as of March 15, 2004 was approximately $22.7 million.

On March 15, 2004, there were 8,575,029 shares of Class A Common Stock, par value $0.01 per share issued, including 125,809 issued and designated as treasury shares, and no shares of Class B Common Stock, par value $0.01 per share, issued or outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive proxy statement for the 2004 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission, are incorporated by reference into Part III of this Annual Report on Form 10-K. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

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Forward-Looking Statements

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations . You should carefully review the risks described herein and in other documents we file from time to time with the Securities and Exchange Commission (SEC), including the Quarterly Reports on Form 10-Q to be filed in 2004. When used in this report, the words expects, could, would , may, anticipates, intends, plans, believes, seeks, targets, estimates, looks for, looks to, and similar expressions, as well as statements r Company s focus for the future, are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. 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.

PART I

ITEM 1. Business

GENERAL

Founded in 1981, Bitstream Inc. (Bitstream or the Company) is a software development company that enables customers worldwide to render high-quality text, browse the Web on wireless devices, select from the largest collection of fonts online, create high-quality variable documents dynamically, and customize documents over the Internet. Its core competencies include fonts, font technology, browsing technology, and publishing technology.

The Company maintains executive offices at 245 First Street, 17th Floor, Cambridge, Massachusetts 02142. Our telephone number is 617-497-6222. We maintain a Web site at *www.bitstream.com*. Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC Web site at *www.sec.gov*.

PRODUCTS AND MARKETS OVERVIEW

The Company categorizes its products and technologies into three business segments: (1) Type, which consists of fonts and font technology, and browsing technology; (2) MyFonts; and (3) Pageflex.

TYPE

FONTS AND FONT TECHNOLOGY

Techniques used to present text and graphics are based on existing desktop publishing technologies and, when used in new distribution media, often result in a loss of visual integrity, degraded system performance, or both. To efficiently deliver digital information that retains the author s intended visual impression, computer systems must use enabling technologies that reduce file size, minimize bandwidth consumption, and operate reliably across heterogeneous computing environments. The evolution of real time operating systems, cell phone operating systems, wireless Internet devices, PDAs, set-top boxes, information appliances, and embedded systems in general will require the transition from text being displayed on these devices as bitmaps, as is currently done today, to text that can be scaled to fit the content being viewed on the device. Text that is easy to read on any device, at any size, and at any resolution is immeasurably important.

Since its establishment as the first independent digital font foundry in 1981, Bitstream has played a leading role in the development of industry-standard font products and enabling technologies, including font rendering

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and display software. The Company has built substantial expertise in digital type design and production, technical font formats, and font portability and compaction software. Bitstream intends to continue to develop or acquire technology to support its leadership position in these areas.

Bitstream has a long history of working with standards organizations worldwide to enhance technological development. Bitstream created the portable font resource (PFR) as a highly compact, resolution independent representation of characters that could be displayed on different systems while retaining font fidelity. Independent organizations responsible for setting digital TV standards have adopted the PFR font format as their standard for digital television, including ATSC (Advanced Television Systems Committee), DAVIC (Digital Audio Visual Council), DVB (Digital Video Broadcasting), DTG (Digital TV Group), MHP (Multimedia Home Platform), ISO/IEC 16500-6:1999 (International Organization for Standardization / International Electrotechnical Commission), and OCAP (OpenCable Application Platform). Bitstream currently supports PFRs through its Font Fusion and TrueDoc font technology solutions.

The Company believes that certain features of its products, such as performance, speed, compact size, system scalability, cross-platform portability, and high typographic quality, will facilitate the adoption of such products in new and emerging markets. These markets include cell and smart phones, handheld and wireless devices, gaming software, Internet and corporate intranet software, interactive TV and set-top boxes, high-definition digital theater and television, and embedded systems. Bitstream is currently developing, adapting, and marketing its enabling technologies and font solutions to third parties whose products address these new and developing markets.

Bitstream s products and technologies have been designed to support existing and new technological and typographic standards, such as Unicode, OpenType, TrueType, and Type 1, and to be embedded within full-featured products produced by OEMs and ISVs. The Company s products have also been designed to function in multi-platform computing environments, including Windows, UNIX, Linux, Macintosh, RTOS (real-time operating systems), and Java. The Company plans to continue to promote the use of its products in multi-vendor configurations.

Our font technology products include:

Font Fusion®, a font rendering software that allows developers of operating systems, software applications, Web applications, low-resolution screen devices, multimedia servers, high-definition television screens (HDTVs), set-top boxes, continuous tone printers, PDAs, and other embedded systems to render high-quality characters in any format, at any resolution, on any device. Font Fusion renders not only high-quality characters in industry-standard font formats, but also high-quality text in compact portable font resource and stroke-based Asian font formats.

btX2, a font rendering software that allows Linux developers to render high-quality characters in industry-standard and highly compact formats. btX2 is able to render eight font formats, including compact PFRs and compact Asian stroke-based fonts that can fit in embedded Linux systems and interactive TV devices, where space and memory are at a premium. btX2 comes with a core set of 13 delta-hinted, TrueType screen fonts. Delta hinting involves fine-tuning fonts so that they look good on the screen, even at small point sizes on low-resolution devices, such as computer monitors. Such a solution gives Linux applications and systems the look and feel that customers experience on Microsoft and Macintosh desktops.

TrueDoc®, a portable font technology that provides for the efficient distribution of text, with fidelity, in a highly compact format. OEMs and ISVs license and incorporate TrueDoc into their products to achieve reliable, compact, and efficient recording, transporting, viewing, and printing of typographic information, whether or not the fonts used for the original creation of the document are resident on the recipient s system. TrueDoc has been engineered to be small in file and application size, to comply with all industry font standards, and to be cross-platform compatible. The Company believes that TrueDoc s small file size and efficient playback capabilities present advantages in applications where limitations on bandwidth and memory are significant factors.

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TrueDoc Imaging System (TDIS), a font rendering software for developers of operating systems, servers, applications, and printer controllers where a complete font solution is needed to provide scaleable resident fonts and support for downloaded, industry-standard fonts.

Our font products include:

Bitstream Typeface Library, which consists of over 900 digital typefaces deliverable in industry-standard OpenType, TrueType, and PostScript Type 1 font formats. Most of these typefaces are for use with English or other Western European language-based computer systems. A large number of typefaces are necessary to support OEMs and ISVs focused on the graphic arts market, who are accustomed to having a wide variety of typeface designs from which to choose. The remainder of the Company s typeface designs are non-Western language typefaces such as Arabic, Chinese, Cyrillic, Greek, Hebrew, Japanese, Korean, and Thai. Bitstream is committed to increasing the number and variety of typeface designs it offers to its customers.

BTN Library, which consists of 500 fonts for OEMs and ISVs. This new BTN (Breaking the Norm) typeface library includes designs made up of text families and pi fonts, and a wide variety of display, headline, and handwriting fonts. The BTN fonts work well in software applications (particularly game software and graphics/presentation applications), Web applications, and printers.

Asian Stroke-based Fonts, which consists of Unicode and native encodings of Chinese, Japanese, and Korean fonts, all in a compact and scalable outline format. Bitstream also provides a unified stroke-based font that includes all Chinese, Japanese, and Korean characters included in the separate fonts.

Tiresias Screenfont, a font that was originally designed by a team led by Dr. John Gill, Chief Scientist for the Royal National Institute for the Blind (RNIB). The RNIB developed the Tiresias Screenfont to improve text for television subtitling. The DVB and DTG organizations have adopted the Tiresias Screenfont as their standard font for digital television.

BROWSING TECHNOLOGY

The Company has also expanded its product lines based on its font technology to include ThunderHawk, a browser for mobile devices. Management believes that the addition of ThunderHawk to its growing product line will significantly expand Bitstream s traditional font technology business into a new business focused on providing leading-edge browsing technology to small handheld devices, such as PDAs and cell and smart phones. Today, Bitstream offers the complete ThunderHawk client-server solution to corporations, wireless carriers and operators, device manufacturers, and consumers.

ThunderHawk is a wireless Web browsing technology for small wireless devices, including Pocket PCs and cell and smart phones. ThunderHawk relies on a server infrastructure combined with a small piece of thin-client code on the handheld device. The server infrastructure transmits Web content in a more compact format to the device, making fast and full-featured wireless Web browsing possible. ThunderHawk s reliance on the server allows smart phones, Pocket PCs, and other wireless devices to have a high degree of compliance with open HTML standards. In addition, ThunderHawk gives customers the fast and full featured browsing capability on a handheld device that they get from the desktop. This includes viewing the full text and images of any Web page without excessive scrolling. ThunderHawk does not rely on WAP (Wireless Application Protocol) or cHTML (Compact HyperText Markup Language). This removes the need for Web content developers to create separate, simplified Web sites optimized for small devices, or for companies to license separate software that converts Web sites into a format appropriate for wireless devices. Instead, ThunderHawk enables users to see a Web page just as it appears on the desktop.

There are three editions of ThunderHawk, described in more detail below.

ThunderHawk Enterprise Server is a client-server technology for corporate environments and telecommunications companies. Providing wireless Web browsing across networks, it gives a mobile workforce complete access to Internet and corporate intranet Web pages. Enterprise Server allows corporate IT departments to deploy ThunderHawk on their networks, giving their mobile workforce access to crucial corporate data, whether on the road or in the office. Employees can make database inquiries, update inventories, order products and publications, communicate with clients in the field, and schedule services and repairs. It is often more convenient for mobile employees to work with small wireless devices than bulky laptops. Enterprise Server also allows companies to display different interfaces to specific users based on permission levels set in intranet applications, thus ensuring information security and privacy. It gives workforces access to secure corporate data without corporations having to sink excess dollars into building specialized or streamlined applications.

ThunderHawk SmartPhone Edition allows consumers to browse the Web on cell and smart phones. It enables wireless carriers and device manufacturers to supplement voice with up-to-date, real-time data services in a format that is familiar to users. With its support for open HTML standards, including CSS and DHTML, and security protocols, such as SSL and 128-bit encryption, ThunderHawk allows wireless carriers to provide complete Web browsing to their customers. In particular, this technology enables a smart phone with a 176x220 color LCD screen to display an 800x946-pixel Web page. A split screen mode allows consumers to easily skim information and quickly find their orientation on a Web page. The upper half of the split screen shows the entire page, while the lower half displays the selected area at full size. Consumers can also work in full screen mode, which displays more of the Web page at once. Bitstream released an alpha version of ThunderHawk SmartPhone Edition in 2003.

ThunderHawk PocketPC Edition allows consumers to browse the Web on Pocket PC devices. It enables a Pocket PC with a 320x240 color LCD screen to display a legible SVGA (800x600) or VGA (640x480) screen of a Web page. In October 2003, Pocket PC magazine awarded ThunderHawk its Best Software of 2003 Award in the Browsers and Web Utilities category. Pocket PC magazine s Best Software Awards celebrate the efforts of developers whose products increase the enjoyment and productivity of Pocket PC and smart phone users.

MYFONTS

Traditionally, individual digital fonts and font packages consisting of a variety of fonts have been sold through many different channels including: (1) catalog sales; (2) resellers who typically offer and sell fonts from multiple foundries; and (3) CD ROMs containing many fonts that can be unlocked by means of a purchased key code. While these approaches to selling fonts are generally satisfactory for professionals, they represent a barrier for the non-professional, casual user who is simply looking for a particular font. For example, if someone sees a font used in a magazine, traditional sales channels offer no quick and easy way of finding out what it is. Even when the name of the font can be determined, it is not obvious where to buy it from among the hundreds, if not thousands, of font foundries offering their fonts through numerous channels. As a result of such obstacles, font sales to non-professionals have historically been almost non-existent. Bitstream believes that this represents a large untapped market for fonts and established MyFonts in 1999 to capitalize on this market. The mission of MyFonts is to make fonts accessible to everyone, which benefits both users and the font foundries. For the general computer user, fonts have been difficult to find, purchase, and install, and often an unknown aspect of their desktop environment. MyFonts hopes to provide access to fonts for all users, not just graphic arts professionals.

In early 2000, Bitstream officially launched the MyFonts.com Web site. Created by Bitstream with the participation of some of the industry s most influential font foundries, the site provides one of the largest collections of fonts ever assembled. It features new ways to find and purchase fonts on-line, and offers unique typographic resources and a forum for interacting with font experts. As of the date of this filing, over 150 foundries, large and small, domestic and international, participate as partners with MyFonts to offer their fonts for sale. This represents an aggregate collection of over 34,000 fonts.

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Some of the key features of MyFonts.com are: (1) an advanced search feature, which enables customers to browse and locate fonts using keywords both a novice and expert can understand; (2) WhatTheFont, which allows customers to scan images of typefaces and upload them to MyFonts.com for identification; (3) the ability to find fonts similar to a particular typeface design using the Show me more fonts like this feature; (4) test driving a font in text the user enters; (5) exploring the world of fonts with links to typographic resources available on the Web; (6) the ability to collect fonts into one or more Font Albums for side-by-side comparison and collaborative decision making; and (7) the ability to interact with font experts and fellow users on-line, ask questions, or join the on-line MyFonts Forum.

MyFonts is designed to handle virtually all fonts available irrespective of their source. The Company s strategy for the MyFonts.com Web site is to become the universal and complete source for fonts from all font vendors and designers. To implement its strategy, the Company approached a number of key font foundries and invited them to participate in the MyFonts.com Web site. Three levels of participation are currently available:

1. Level 1 A participating font foundry provides copies of its fonts for addition to the MyFonts database, thereby making its fonts available to all searching and browsing facilities. In addition, it allows users to see images of the fonts for evaluation and comparison. If customers want to purchase a font from a participating foundry, they follow a link to the foundry s Web site where the purchase actually takes place. MyFonts collects no direct revenue from these sales. In many cases, however, MyFonts earns referral fees when such purchases are made.

2. Level 2 Similar to level 1, except the participating foundry allows its fonts to be sold directly by MyFonts. With each sale, MyFonts pays a royalty to the foundry.

3. Level 3 Similar to level 2, except the participating foundry shares in the ownership and control of MyFonts. As of the date of this filing, no participants have elected to participate at this level.

Since launching the e-commerce portion of its Web site, the Company has monitored sales and feedback from its users and used this information to make ongoing improvements to the Web site. As a result, the Company believes that the current Web site presents substantially fewer obstacles to finding and buying fonts than any other Web site offering fonts for sale.

PAGEFLEX

Corporate marketing departments in the United States spend approximately $20 billion on commercial printing each year. Market Research firm CAP Ventures estimated that for every dollar spent on printed product, ten dollars is spent in creating, revising, ordering, warehousing, distributing, and obsoleting inventory. Marketing documents are typically created through an expensive, labor-intensive process. After all the text and image content has been created, the process of laying the content out on a page and preparing it for the printing press involves two or three separate departments or firms, with manual intervention and rework by each. The desktop publishing revolution has made the process of developing the component text, images, tables, charts, and illustrations very efficient. However, once an original design is created, the process by which other people such as dealers, distributors, and franchisees implement and customize it for their local situation is cumbersome at best. This workflow requires sending multiple drafts back and forth between designer and content provider, which takes shipping time and adds to the labor time and cost.

In the past few years, corporate marketing departments have learned to take advantage of the Web as a new marketing medium. These departments are becoming familiar with the qualities and opportunities of the new medium, such as the abilities to update information quickly and easily, to generate content pages dynamically directly from corporate databases, and to personalize the customer experience. At the same time, companies are realizing the increased customer loyalty and profits that result from treating customers as individuals. They recognize the importance of identifying their most valuable customers and lavishing attention on them in a way

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tailored specifically to their needs. Marketing industry consultants Don Peppers and Martha Rogers have popularized the notion of marketing to an audience of one. To implement one-to-one communications, all marketing communications must be moved from a one-size-fits-all approach to a custom manufacturing model, in which thousands of variations can be produced at low cost. The market is demanding solutions to implement this one-to-one concept. With the advent of high-speed color printers and digital presses, it is no longer cost-prohibitive to print smaller quantities, whether for localized marketing materials (short-run) or for one-to-one personalized materials (a run of one).

Pageflex products and technologies consist of:

Mpower, an integrated suite of software applications that gives enterprises in many industries and digital printing service providers the ability to design and produce customized database-driven or Web form-driven marketing communications on demand. Mpower can assemble complex projects dynamically and deliver them instantly in print or bitmap formats to a wide range of output devices, the Web, and e-mail. Mpower can use customer profile information about a recipient to control the selection of digital content for a document, including its logos, imagery, illustrations, and text. The customer profile information is stored in a database or collected from a Web form. Mpower then uses intelligent, flexible templates to automatically assemble this personalized content into final documents for output. Mpower is based on the principle of separating document content from document design. Content is the raw information, and form is the presentation how the page is laid out, what fonts and colors are used, and how images are sized and positioned. Pageflex captures the design of a document in the form of a flexible, intelligent template that represents the original vision for the page. The copy-fitting and placement rules, together with permissions that govern user ability to change elements, are built into each design template by the designer. The designer is thus able to protect the whole from degradation and damage by content providers. Content providers can modify and add their content with little or no design skill. Document designs originally developed in Quark Xpress, Adobe InDesign, Microsoft Word, or other applications can be imported into Mpower through the use of Pageflex plug-ins that enable these third-party applications to export to the Pageflex XML data format.

.EDIT is the first Web browser-based design and editing application that enables non-designers to create typography-rich, layout-rich documents with just a browser and an Internet connection. It is the only technology available that provides an interactive user experience, a true WYSIWYG display, Web-browser access and on-the-fly composition for preview, soft proofing and final output. .EDIT represents a revolutionary level of interactivity for Web-to-print solutions. It enables companies to offer interactive document editing capabilities to customers, employees, marketing partners, and dealers or franchise owners over a corporate Web site. Users need only a Web browser and an Internet connection, without any plug-ins or additional software applications. Customers deploying .EDIT on their Web site can create templates that maintain their brand and corporate identity by using approved fonts, design elements, and images. They can also limit the editing capabilities made available to their end users and constrain portions of the document so that they cannot be modified.

Persona, a variable content publishing application, allows users to create sophisticated, personalized documents in PDF, PostScript, or PPML. Persona is an easy-to-use desktop application for Windows, consisting of a subset of features from Mpower. Built upon open standards, Persona is the first variable content publishing solution to use XML as the intermediate data format between databases and the page composition process. Like all Pageflex offerings, Persona incorporates flex capabilities, enabling element container sizes to automatically stretch or shrink based on the size or orientation of the content that flows into them. In addition, surrounding containers move in concert ensuring that design integrity is maintained.

NuDoc is an advanced document composition engine based on the principle of separating form from content. Leveraging object-oriented technology, NuDoc is a reusable building block for document processing applications. NuDoc object classes provide an application programming interface (API) that supports the importing, editing, displaying, or printing of electronic documents. One of the strengths of

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NuDoc is its ability to dynamically create layout-intensive pages through import of separate content and style files. The Company is making plans to develop its NuDoc composition engine for XSL. This version of NuDoc will make Pageflex solutions based entirely on open standards, using XML for content and XSL for form, and joining them together to create PDF, PostScript, and other output formats.

The Company s Pageflex products and technologies have been designed to support technological standards. Pageflex is a founding member of the Print On Demand Initiative (PODi), an alliance of key vendors and service providers working in the digital color printing market. PODi members include Adobe, Creo, Electronics for Imaging (EFI), Hewlett-Packard, IBM, and Xerox. Pageflex also participates in the PODi Personal Printing Initiative (PPI). The PPI has completed and released a PPML standard harmonizing the ten vendor-specific proprietary protocols currently used to drive digital presses at high speed into one open standard supporting PostScript, PDF, and AFP. Pageflex software, since its inception, has sought to drive all brands of digital printers. With strong Pageflex input, PPML has been adopted as a standard across the industry, and Pageflex continues to play a leading role in the standardization program. Pageflex also is actively involved in the Extensible Stylesheet Language (XSL) working group of the World Wide Web Consortium (W3C). Pageflex was invited onto the committee by the chairperson, based on the Company s years of experience developing style sheet languages. XSL is one of the components of the W3C XML standards effort. Dr. Jeffrey Caruso represents Pageflex and serves along with representatives from Adobe, Sun, IBM, Microsoft, and about twenty other prominent firms. Dr. Caruso worked with Adobe to co-edit the print-oriented formatting part of the standard. In October 2001 the World Wide Web Consortium released XSL 1.0 as a formal W3C Recommendation.

SALES & MARKETING

Sales and marketing efforts are managed from the Company s corporate headquarters in Cambridge, Massachusetts. Sales personnel receive a base salary plus commissions based on meeting sales targets, with additional commissions for sales in excess of annual targets. The Company also seeks to enhance its relationships with existing and potential customers and has training and technical support teams who work with existing and potential customers, resellers, and strategic partners to support the sales process and to facilitate the implementation and use of the Company s software products and technologies. Type also has a sales agent based in Tokyo to facilitate OEM sales to Japanese hardware manufacturers.

Type promotes its products through attendance and exhibition at major industry trade shows, participation in standards committees for digital television, and through its Web site, *www.bitstream.com*. The principal objective of Type s marketing strategy is to continue to expand the sale of Type s font technologies to OEMs and ISVs, who integrate Type s software into their own products; and to continue to expand the sale of its fonts to retail customers. OEM and ISV agreements range from a license for a small group of typefaces to agreements whereby an entire range of font products and/or technologies are incorporated into the customer s hardware or software products. As new opportunities arise, the Company intends to evaluate other marketing approaches.

The ThunderHawk sales team is focused on increasing direct sales to corporations and end-users, as well as, on maintaining and expanding relationships with resellers and wireless carriers. The Company promotes its ThunderHawk technologies through attendance and exhibition at major industry trade shows, such as CTIA; through advertising in wireless and PocketPC publications; and through the Web at *www.bitstream.com/wireless*. The principal objective of the Company s ThunderHawk marketing strategy is to continue to expand awareness of its browsing technologies to wireless carriers, corporations with mobile work forces, and end users.

Since its inception, MyFonts marketing activities have been focused on recruiting participation from font foundries, making Web users aware of MyFonts.com and attracting them to the Web site. Since 2002, the Company has focused marketing efforts for MyFonts.com on increasing awareness of, and sales on, the site. Marketing activities to increase awareness on the part of potential font buyers consists of a tradeshow presence in combination with efforts aimed at building Web links from search engines and other Internet sites, as well as

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referrals. To complement this presence, the Company strives to further increase awareness by encouraging editorial coverage in relevant publications and through print and Internet advertising. Analysis of sales results suggests that most of MyFonts.com s customers find the site by means of search engine queries. The Company has worked and continues to work vigorously to develop and improve its ranking on search engines. In addition, the Company enters into referrer agreements with selected Internet sites that share a portion of revenue in return for referring new customers and has established relationships connecting font management software published by Corel Corporation and Extensis. Using the same technology that enables font managers to handle the purchasing and addition of fonts, MyFonts also provides back-end font searching and e-commerce facilities to other Web sites, including *www.bitstream.com*.

The Pageflex sales and marketing organization is focused on direct sales and marketing activities, as well as, on maintaining and expanding reseller and OEM relationships. Pageflex promotes its products through attendance and exhibition at major industry trade shows such as Direct Marketing and Print on Demand; through participation in booths sponsored by its strategic partners, like EFI, Xerox, and Creo; through advertising in industry publications; and through its Web site, *www.pageflex.com*. The principal objective of Pageflex marketing strategy is to continue to expand awareness of its on-demand marketing software products to Web-to-print providers, digital service and print providers, corporate marketing departments, design firms, advertising agencies, direct mail houses, and other corporations and end users.

CUSTOMERS

Type licenses its font and font technology products to a variety of OEM and ISV customers worldwide. The Company also sells custom and other typeface products directly to corporate customers and individual end users. The Company licenses its ThunderHawk browsing technology to corporations, wireless carriers and operators, device manufacturers, and consumers. No single Type segment customer accounted for 10% or more of the Company s revenue for any of the years ended December 31, 2003, 2002, or 2001. For the years ended December 31, 2003 and 2001, no single Type customer accounted for 10% or more of the revenue for that segment. For the year ended December 31, 2002, one Type customer accounted for 10% of the revenue for that segment.

MyFonts licenses fonts to consumers worldwide through its e-commerce Web site. No single MyFonts segment customer accounted for 10% or more of the Company s revenue or the MyFonts segment s revenue for the years ended December 31, 2003, 2002, or 2001.

Pageflex licenses its products directly to Web-to-print providers, print service providers, major corporations and end users, and indirectly through resellers and strategic partners. No single customer of the Pageflex business segment accounted for 10% or more of the total Company revenue for the years ended December 31, 2003, 2002 and 2001, nor did any single Pageflex customer account for 10% or more of that segment s revenue during those years. The Company intends to continue to broaden its customer base through increased marketing efforts, by developing relationships with systems integrators, OEMs, and partners in 2004, and by introducing new product offerings.

From time to time, product sales to large customers during a single fiscal quarter may constitute more than 10% of Company revenue for such quarter. The Company has broadened and intends to continue to broaden its customer base through expanded product offerings and increased marketing efforts. Revenue by geographic area is included in Footnote 10 in the Notes to the financial statements enclosed herewith.

RESEARCH AND DEVELOPMENT

Bitstream is committed to developing innovative software to enhance the browsing experience on wireless devices and to improve text imaging. Bitstream is also committed to developing leading-edge technology for its

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MyFonts.com Web site, and to advancing the Company s on-demand marketing products and technologies. To accomplish these goals, the Company has invested, and expects to continue to invest, significant resources in research and development.

During 2003, the Company s research and development activities produced:

ThunderHawk SmartPhone Edition mobile Web browsing technology for cell and smart phones. The alpha version was launched in October 2003 and the beta version was completed in February 2004. The SmartPhone Edition allows wireless carriers and device manufacturers to supplement voice with up-to-date, real-time data services in a format that users are familiar with. This technology enables a smart phone with a 176x220 color LCD screen to display an 800x946-pixel Web page. A split screen mode allows consumers to easily skim information and quickly find their orientation on a Web page. The upper half of the split screen shows the entire page, while the lower half displays the selected area at full size. Consumers can also work in full screen mode, which displays more of the Web page at once. The Company believes that the release of the SmartPhone Edition in 2004 will set a new standard for browsing on these devices.

ThunderHawk Enterprise Server and ThunderHawk Pocket PC Edition, both at version 1.09 as of December 31, 2003, were further developed to include stronger device support, faster download capabilities, and an improved online installation process. The Company plans to release Version 2.0 of these technologies by the second or third quarter of 2004.

Font Fusion 2.4 Type s smallest, most advanced font rasterizing engine, and we believe the fastest font engine on the market. The new version released included improved support for Adobe OpenType fonts; enhanced support for Type 1 fonts, allowing access to all characters; and a plug-in filter for emboldening of bitmaps. Work also continued on future Font Fusion technologies.

Mpower 4.0 An upgrade to the flagship Pageflex product with extensive features for long document support, including variable-length document capability. New features include master pages, automatic page insertion based on overflow, variable-page insertion based on user-defined values, dynamic filler page insertion for signature maintenance, automatic page and section numbering, header and footer controls, and automatic table of contents generation. Also supported is fully paginated stitching in of multi-page PDF files and Pageflex documents. Mpower 4.0 was released in July 2003. The Company believes that Mpower 4.0 defines the state of the art for Web-to-print variable-data publishing software. Mpower 4.0 provides all functions needed to produce variable-length customized documents while automatically paginating each document and maintaining design and brand integrity.

EDIT 3.0 An upgrade to the latest Pageflex offering which included significant enhancements for both users and deployers. For users, new capabilities were added for image uploading, cropping and scaling, as well as for text importing and spell checking. For deployers, new capabilities were added enabling the creation of simple pop-up or point-and-click options in the user interface for the placement of static text or variable formatted content into documents. Pageflex .EDIT 3.0 also added the capability for changing page size dynamically. Users can now increase or decrease page dimensions on the fly during a Web editing session, so that elements within the design flex and re-flow to protect the visual design within the new boundaries. The Company believes that this functionality is a key differentiating factor in providing solutions for online ad building, where a single ad design might need to be produced in multiple sizes for multiple ad placements.

COMPETITION

The Company s font technology products compete with the solutions offered by a variety of companies, including other suppliers of enabling technologies, software application developers, and vendors of computer operating systems. Moreover, the market for the Company s enabling technologies and products may be

adversely affected by the extent that computer hardware, operating system, and application software vendors incorporate similar functionality or bundle competitive offerings with their products and thereby reduce the market for the Company s technology or products. The competition for the Company s sales of typefaces generally comes from a number of comparably sized or smaller companies offering their own typeface libraries and custom typeface services. Competition with the Company s enabling technologies principally comes from Agfa Monotype with its iType and Universal Font Scaling Technology (UFST). UFST has a similar architecture to the Company s TrueDoc Imaging System (TDIS). The competition for Font Fusion and TrueDoc consists primarily of software from Agfa Monotype, which includes a font rendering technology known as iType and a font compression technology known as MicroType Express. In addition, competition for Font Fusion, btX2, and TrueDoc comes from FreeType, an open source collaborative organization that provides its Linux font rendering code for free. Two limitations of the FreeType organization are its inability to provide fonts; and its inability to provide a license for TrueType hinting, important for rendering readable, legible characters and retaining character shapes at small sizes on low-resolution screens and computer monitors. Both Bitstream and Agfa Monotype can license TrueType hinting technology and fonts to developers.

Bitstream s ThunderHawk browsing technology competes with the browsing solutions offered by a wide variety of companies, including large software companies and small companies focused on delivering solutions to a narrow part of the browser market. The markets for browsing solutions are the subject of intense industry activity, and it is likely that a number of software developers are devoting significant resources to developing and marketing technology and products that may compete with the Company s technology and products. Bitstream believes ThunderHawk compares favorably against the competition because of the desktop-like Web browsing experience, robust code, and compliance with open HTML standards. Browser competitors include Pocket Internet Explorer from Microsoft Corporation; Opera for Smartphone/PDA from Opera Software ASA; NetFront from Access Co. Ltd.; and Blazer from PalmOne, Inc. The competing solutions produce a more limited browsing experience by offering a scrollable view of only a small section of the Web page or by reformatting the page into a tall one-dimensional structure.

Competitors to MyFonts include individual font foundry Web sites and other font-related Web sites that offer a variety of fonts for sale online, including fonts.com, owned and operated by Agfa Monotype. However, MyFonts believes that it has no direct competitors who offer such a wide variety of fonts on one easy-to-use Web site aimed at people who have never previously purchased a font. But there can be no assurance that consumers will prefer to use MyFonts.com over Web sites hosted by individual font foundries.

The Company s Pageflex software competes with vendors offering end-to-end solutions and integration services that include on-demand publishing tools. These solutions in turn compete with solutions created by Pageflex customers. Mpower and .EDIT are server-based enterprise applications targeted at the customized print or Web-to-print segment of the on-demand publishing market. This market is characterized by rapid technological developments and frequent product introductions.

Participants in this market compete based on functionality, price, service, customizability, and interoperability with other e-publishing solutions and components. These competitors include Banta, DeskNet, Digital VIP, Saepio, XMPie, Quark DDS and 3B2 Online. In addition, Pageflex may face new competition from emerging products and technologies. Pageflex believes its products compete favorably based on rich feature sets, ease of use, stability, and scalability.

The Company believes that the principal competitive factors affecting all of its products include product features and functionalities, such as scalability, ease of integration, ease of implementation, ease of use, quality, performance, price, customer service and support, and effectiveness of sales and marketing efforts. Although the Company believes that it currently competes effectively with respect to such factors, there can be no assurance that the Company will be able to maintain its competitive position against current and potential competitors.

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INTELLECTUAL PROPERTY

The Company relies on a combination of trade secret, copyright, patent, and trademark laws and contractual restrictions to establish and protect proprietary rights in its technology. The Company has entered into confidentiality and invention assignment agreements with its employees, and when obtainable, enters into non-disclosure agreements with its suppliers, distributors and others so as to limit access to and disclosure of its proprietary information. There can be no assurance that these statutory and contractual arrangements will prove sufficient to deter misappropriation of the Company s technologies or that the Company s competitors will not independently develop non-infringing technologies that are substantially similar to or superior to the Company s technology. The laws of certain foreign countries in which the Company s products are or may be developed, manufactured or licensed may not protect the Company s products or intellectual property rights to the same extent as do the laws of the United States and thus make the possibility of piracy of the Company s technology and products more likely. The Company believes that, because of the rapid pace of technological change in the software and electronic commerce markets, legal protection for its products will be a less significant factor in the Company s future success than the knowledge, ability and experience of the Company s employees, the frequency of product enhancements and the ability of the Company to satisfy its customers.

The Company s policy is to apply for U.S. patents with respect to its technology and seek copyright registration of its technology and trademark registration of its marks from time to time when management determines that it is competitively advantageous and cost effective to do so. The Company has been granted five patents by the United States Patent and Trademark Office, three of which are directed to certain aspects or applications of the Company s TrueDoc technology; one of which is directed to the Company s DocLock technology; and one patent directed to the Company s Font Fusion technology. Furthermore, multiple U.S., PCT, EPO, and Japanese applications are pending on some of the Company s newer technologies. The Company is currently in the process of registering several trademarks and preparing a variety of patent applications relating to MyFonts.com and its Pageflex software. Bitstream®, Font Fusion®, TrueDoc®, T2K®, MyFonts® and Cyberbit® are federally registered trademarks of the Company or its subsidiaries. All other trademarks, service marks or trade names referred to in this Annual Report on Form 10-K are the property of their respective owners.

EMPLOYEES

As of March 15, 2004, the Company employed 54 persons, including 13 in sales and marketing, 6 in customer support and consulting, 24 in research and development, and 11 in general and administrative functions. Of the Company s 54 employees, 51 are full time and 3 are part time. The Company also retains consultants from time to time to assist it with particular projects for limited periods of time. The Company believes that its future success will depend in part on its ability to attract, motivate and retain highly qualified personnel. None of the Company s employees is represented by a labor union and the Company has not experienced any work stoppages. The Company considers its employee relations to be good.

EXECUTIVE OFFICERS OF THE REGISTRANT

The Company s executive officers and their ages as of March 15, 2004 are as follows:

Name	Age	Position
Anna M. Chagnon	37	President, Chief Executive Officer and General Counsel
John S. Collins	64	Vice President and Chief Technology Officer

James P. Dore	45	Vice President and Chief Financial Officer
Sampo Kaasila	43	Vice President, Research and Development
Costas Kitsos	43	Vice President of Engineering
Michael Mattozzi	48	Vice President of Sales for ThunderHawk

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Anna M. Chagnon has served as Chief Executive Officer of the Company since October 2003. She has also served as President of the Company since June 2000 and as General Counsel since July 1997. She previously served as Chief Operating Officer from August 1998 to October 2003, and Chief Financial Officer from August 1998 to March 2003. From July 1997 to August 1998, she served in various positions at the Company including Vice President, Finance and Administration, Chief Financial Officer and General Counsel, and Vice President and General Counsel. From November of 1996 to July 1997, Ms. Chagnon was Counsel to Progress Software Corporation, a developer and worldwide supplier of solutions to build, deploy and manage applications across Internet, client/server and host/terminal computing environments. From August 1994 to November 1996 she was an attorney for the Boston law firm of Peabody & Arnold LLP where she specialized in corporate, securities, finance and intellectual property law. She holds a Bachelor of Science degree, summa cum laude, from Northeastern University, a Juris Doctor degree from Boalt Hall School of Law of the University of California at Berkeley, and a Master of Business Administration, summa cum laude, from Babson College.

John S. Collins has been Vice President and Chief Technology Officer since August 1998. From 1988 to August 1998, he served as Vice President of Engineering. Mr. Collins was the inventor or a co-inventor of a number of the patents held by the Company relating to font imaging technology. He is the principal inventor of the Company s TrueDoc technology. Mr. Collins holds a B.Sc. and a Ph.D. in Electrical Engineering from the University of London.

James P. Dore was named a Vice President and the Company s Chief Financial Officer in March 2003. From June 1999 to March 2003, he served as the Corporate Controller for the Company. From January 1997 to June 1999, Mr. Dore served as Corporate Controller at Celerity Solutions Inc. (bulletin board- CLTY), a developer and marketer of supply chain and warehouse management business software, he also served as Celerity s Chief Financial Officer and Treasurer from April 1999 to June of 1999. Mr. Dore has over twenty years of service in various senior financial positions, holds a C.P.A. certificate and a B.S. degree, with distinction, from Clarkson University.

Sampo Kaasila has served as Vice President, Research and Development, of the Company since November 2001. Mr. Kaasila serves as the principal architect of the Company s Font Fusion and ThunderHawk products. From November 1998, when Mr. Kaasila joined Bitstream upon the acquisition of Type Solutions, Inc., to November 2001, he served as Director of Research and Development, Type Solutions. From August 1989 to November 1998, he was a founder and President of Type Solutions, Inc., a leading developer of font technologies including T2K, a font renderer which provides an object oriented design, advanced architecture and algorithms, and a clean API resulting in maximum reliability, performance, and easy integration. From August 1987 to August 1989, Mr. Kaasila worked at Apple Computer, Inc. and was the lead engineer and inventor of the True Type technology now part of every MacIntosh and Windows PC. Mr. Kaasila holds a Masters degree in Electrical Engineering from the Royal Institute of Technology in Stockholm, Sweden where he graduated first in his class in January 1983.

Costas Kitsos has been Vice President of Engineering since November 1999. Mr. Kitsos serves as principal architect of the Pageflex Mpower and Persona products, and is also the technical lead for the Company s end user type application products. From October 1998 to November 1999, he served as Director of Research and Development of the Company. From November 1996 to October 1998, he was a Senior Software Engineer at the Company. Mr. Kitsos is a veteran software developer with over ten years experience in type and publishing application development. From May 1987 to November 1996, Mr. Kitsos headed IconWorks, which developed award winning type applications and offered consulting services on end user programs and graphical user interfaces. He holds a Masters degree from the University of California, Los Angeles.

Michael Mattozzi has been Vice President of Sales for ThunderHawk since August 18, 2003. From April 2001 to March 2003 he served as Area Sales Director for Business Objects S.A., a leading business intelligence software company. From June 2000 to March 2001 Mr. Mattozzi served as Vice President of Sales, Eastern and Canada Regions for SABA Software, a leading provider of human capital development and management solutions. From

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January 1998 to June 2000, he served as Vice President of Sales, Eastern Region for Open Text, Inc., a leader in providing Enterprise Content Management solutions. Mr. Mattozzi has over 20 years of experience in sales leadership and has held various sales positions at other companies including Cullinet Software, Image Business Systems, and FileNet. Mr. Mattozzi is a graduate of the University of Massachusetts at Amherst.

ITEM 2. Properties

The Company s corporate headquarters are located in Cambridge, Massachusetts where the Company currently leases approximately 18,000 square feet under an operating lease expiring in August 2009. The minimum annual base rent including operating expenses, property taxes and assessments is approximately $424,000 for the first two years with the first six months abated, $460,000 for years three and four, and $478,000 for years five and six.

The Company also leases a small engineering office in Plaistow, New Hampshire for approximately $1,000 per month on a month to month basis.

Management believes that these facilities are adequate for the Company s current needs and that suitable additional space, should it be needed, will be available on commercially reasonable terms.

ITEM 3. Legal Proceedings

On June 24, 2003, Agfa Monotype Corporation and International Typeface Corporation filed a complaint in the U.S. District Court for the Northern District of Illinois Eastern Division claiming that the Company, through its TrueDoc software, infringes trademarks and copyrights and violates the Digital Millennium Copyright Act. The complaint fails to identify any of the plaintiffs trademarks or copyrights that have been allegedly infringed and does not specify any amount of monetary damages. The plaintiffs do seek injunctive relief, but do not make any statement that any of the alleged acts have actually taken place. The Company is contesting these claims.

From time to time, in addition to the infringement case identified above, the Company is 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. In accordance with generally accepted accounting principles, the Company makes 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 December 31, 2003 no liability has been recorded. Litigation is inherently unpredictable and it is possible that the Company s financial position, cash flows, or results of operations could be affected in any particular period by the resolution of one or more of these contingencies.

ITEM 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2003.

PART II

ITEM 5. Market for Registrant s Common Equity and Related Stockholder Matters

MARKET INFORMATION

Effective February 28, 2003 the Company s Common Stock was transferred from the Nasdaq National Market to the Nasdaq Small Cap market. The application to transfer to the Nasdaq Small Cap Market was made

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in response to a notice from Nasdaq that the Company was not compliant with Nasdaq s new continuing listing requirement, which became effective November 1, 2002. Nasdaq changed its National Market System continued listing standard from a minimum $4,000,000 net tangible asset requirement to a minimum $10,000,000 stockholders equity requirement. Bitstream did not comply with the $10,000,000 stockholders equity requirement, as its stated equity as of December 31, 2002 was $6,000,000. Upon consideration of the factors involved, the Company elected to transfer from the Nasdaq National Market. Bitstream s common stock continues to trade under its current symbol BITS.

The Class A Common Stock of the Company began trading publicly on the Nasdaq National Market tier of The Nasdaq Stock Market on October 30, 1996 under the symbol BITS . Prior to October 30, 1996, there was no public market for Bitstream s Class A Common Stock. The following table sets forth the high and low closing sale prices of the Company s Class A Common Stock as reported on the Nasdaq National Market for the period commencing January 1, 2002 and ending February 27, 2003, and on the NASDAQ Small Cap Market for the period commencing February 28, 2003 and ending December 31, 2003. Such information reflects interdealer prices, without retail markup, markdown, or commission, and may not represent actual transactions.

	2003		2002	
	High	**Low**	**High**	**Low**
First Quarter	2.180	1.460	7.100	3.350
Second Quarter	2.840	1.570	4.720	2.750
Third Quarter	5.000	2.280	2.940	1.850
Fourth Quarter	6.100	2.890	2.090	1.470

As of March 15, 2004, the Company s Class A Common Stock was held by approximately 100 holders of record and the Company believes that the Company s Class A Common Stock was beneficially held by more than 500 holders. The Company s Class B Common Stock was not held by any holders of record.

DIVIDENDS

The Company has never declared or paid cash dividends on its capital stock. The Company currently intends to retain earnings, if any, to support its growth strategy and does not anticipate paying cash dividends on its capital stock in the foreseeable future.

RECENT SALES OF UNREGISTERED SECURITIES

During the years ended December 31, 2003, 2002, and 2001, the Company issued an aggregate of 97,904, 46,832, and 499,117 shares, respectively, of Class A Common Stock in connection with the exercise of vested options and warrants issued under the Company s 1994 Stock Plan, 1996 Stock Plan, 1997 Stock Plan, and 2000 Stock Plan. There were no unregistered securities sold by the Company during the three years ended December 31, 2003. The sales and issuances of securities in the transactions described above were deemed to be exempt from registration under the Securities Act of 1933, as amended, by virtue of Rule 701 promulgated thereunder, in that they were issued either pursuant to written compensatory benefits plans or pursuant to a written contract relating to compensation, as provided by Rule 701. In addition, on October 25, 2001, the Company filed a Registration Statement on Form S-8 under the Securities Act of 1933, as amended, registering up to an aggregate of 1,000,000 shares of the Company s Class A Common Stock, par value $0.01 per share, which may be issued upon exercise of stock options and warrants granted or which may be granted under the Company s 2000 Stock Plan.

ITEM 6. Selected Consolidated Financial Data

The selected consolidated financial data presented below as of December 31, 2003 and 2002, and for the three years then ended has been derived from, and are qualified by reference to, the Company s consolidated

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financial statements, which have been audited by independent accountants, whose reports thereon are included elsewhere in this Report. The selected consolidated financial data presented below as of December 31, 2001, 2000, 1999, and for the two years ended December 31, 2000 and 1999 have been derived from, and are qualified by reference to, the Company s audited financial statements, which are not included in this Report. The selected consolidated financial data set forth below should be read in conjunction with, and are qualified by reference to, the Consolidated Financial Statements of the Company and Notes thereto, Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Report, and other financial data appearing elsewhere herein.

SELECTED CONSOLIDATED FINANCIAL DATA,

(in thousands, except per share amounts).

	Years Ended December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
Operations:					
Revenue	$ 9,726	$ 8,467	$ 7,968	$ 8,982	$ 8,921
Loss before provision (benefit) for income taxes	(1,128)	(1,067)	(3,314)	(2,894)	(3,052)
Net loss	(1,205)	(1,022)	(3,481)	(3,139)	(4,042)
Net loss per share(1)					
Basic and diluted	(0.14)	(0.12)	(0.43)	(0.41)	(0.56)
Financial Position:					
Cash and cash equivalents	4,367	4,828	5,716	7,149	9,037
Working capital	3,506	3,718	4,688	7,371	9,668
Total assets	7,011	7,964	8,839	12,107	14,603
Stockholders equity	4,939	6,000	6,996	10,049	12,742

The consolidated financial statements for fiscal years 1999 through 2001 were audited by Arthur Andersen LLP, which has ceased operations. A copy of the report previously issued by Arthur Andersen on the Company s financial statements as of December 31, 2001 and 2000, and for each of the three years in the period ended December 31, 2001, is included elsewhere in this document. Such report has not been reissued by Arthur Andersen.

(1) Calculated on the basis described in Note 2 of Notes to the Consolidated Financial Statements.

ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

CRITICAL ACCOUNTING POLICIES

The Company has identified the policies below as critical to its business operations and the understanding of its results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout Management s Discussion and Analysis of Financial Condition and Results of Operations where such policies affect the Company s reported and expected financial results. Note that the Company s preparation of this Annual Report on Form 10-K requires it to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates.

Revenue Recognition

The Company derives revenue from the sale of its software products, professional consulting, and support and maintenance services. License revenue is recognized when persuasive evidence of an agreement exists, the

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product has been delivered or services have been provided, the fee is fixed or determinable, and collection of the fee is probable. From time to time the Company will enter into extended payment programs with creditworthy customers. Revenue related to extended payment programs is recognized when payment becomes due to the Company. In making its decision to recognize revenue the Company must make a determination of the credit worthiness of its customer. This determination involves management judgment and while management believes that it can make reliable judgments, there is no guarantee that the revenue recognized will be collected. The credit worthiness of customers is further analyzed in connection with the Company s accounts receivable.

The Company recognizes revenue under multiple-element arrangements using the residual method when vendor-specific objective evidence (VSOE) of fair value exists for all of the undelivered elements under the arrangement. The Company has established sufficient VSOE for the value of its consulting, training, and other services, based on the price charged when these elements are sold separately. Accordingly, software license revenues are recognized under the residual method in arrangements in which software is licensed with consulting, training or other services. The Company s products and the industries in which they compete are not static and the determination of VSOE involves judgment. Management believes that it will continue to be able to use the residual method for recognizing license revenue under multiple-element arrangements. If the Company was unable to continue to use the residual method, it could affect the timing of revenue recognition and thus the trends that the Company is currently experiencing.

Professional services include custom design and development and training. The Company recognizes professional services revenue under software development contracts as services are provided for per diem contracts or by using the percentage-of-completion method of accounting for long-term fixed price contracts. Provisions for any estimated losses on contracts in progress are made in the period in which such losses become probable. The Company had no long-term contracts in progress as of December 31, 2003.

Revenue from end user product sales is recognized upon delivery of the software, net of estimated returns and allowances, if collection is probable. The Company estimates returns and allowances based on historical rates and as of December 31, 2003 does not have a reserve as returns and allowances have been negligible. If and when a reserve is necessary the Company would reduce revenue recognized for estimated future returns at the time the related revenue is recorded. The estimates for returns are adjusted periodically based upon historical rates of return. While management believes that it can make reliable estimates, it is possible that these estimates will change in the future or that actual amounts could vary materially from our estimates.

The Company generally warrants that its products will function substantially in accordance with documentation provided to customers for approximately 90 days following initial delivery. As of December 31, 2003, the Company had not incurred any expense related to warranty claims. The Company estimates reserves based on historical rates and accordingly has not recorded a warranty reserve. While management believes that it can make reliable estimates, it is possible that these estimates will change in the future or that actual amounts could vary materially from our estimates.

Please refer to Note 1 of the Company s Notes to Consolidated Financial Statements for further information on its revenue recognition policies.

Impairment of Long-Lived Assets

In accordance with the Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, the Company tested recorded goodwill attributable to each reporting unit for impairment. Management conducted impairment testing as of December 31, 2003 and determined that the fair value of its reporting units were greater than the carrying values for those units. Though none of the unamortized goodwill was impaired, there can be no assurance that when a future review is completed a material impairment charge will not be recorded.

SFAS No. 142 required certain disclosures upon adoption that the Company has included in Note 1(j) in the Notes to the Consolidated Financial Statements included herewith.

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Accounts receivable

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer s current credit worthiness, as determined by the Company s review of their current credit information. The Company continuously monitors collections and payments from customers and maintains a provision for estimated credit losses based on its historical experience and any specific customer collection issues that the Company has identified. While such credit losses have historically been within the Company s expectations and appropriate reserves have been established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has experienced in the past.

Income taxes

As part of the process of preparing consolidated financial statements the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within its consolidated balance sheet. The Company must then assess the likelihood that its deferred tax assets will be recovered from future taxable income and to the extent the Company believes that recovery is not likely, it must establish a valuation allowance. To the extent the Company establishes a valuation allowance or increases this allowance in a period, it must include an expense within the tax provision in the statement of operations. Significant management judgment is required in determining the Company s provision for income taxes, the Company s deferred tax assets and liabilities and any valuation allowance recorded against the Company s net deferred tax assets. The Company has fully reserved against its tax asset. The valuation allowance is due to uncertainties related to the Company s ability to utilize its deferred tax assets, primarily consisting of certain net operating losses carried forward and foreign tax credits, before they expire. The valuation allowance is based on the Company s estimates of taxable income by jurisdiction in which the Company operates and the period over which its deferred tax assets will be recoverable. The determination of the valuation allowance requires the Company to make estimates, which the Company cannot guarantee will prove to be accurate.

OVERVIEW

Bitstream Inc. is a software development company that focuses on the presentation of data. Its core competencies include font technology, browsing technology, e-commerce technology, and publishing technology. Bitstream s offering is made up of four distinct product lines: type and type technology, and ThunderHawk, which are both reported under the Company s Type business segment (Type), MyFonts.com (MyFonts) and Pageflex. Bitstream is a leading developer of font technology, digital fonts, and custom font designs. Bitstream licenses its TrueDoc® and Font Fusion® technologies to Web and application developers, and to manufacturers of information appliances, wireless and handheld devices, set-top boxes, embedded systems, and printers. ThunderHawk is a client-server technology that brings full-featured wireless Web browsing to mobile devices. It gives customers complete Internet access to real Web pages while maintaining full text legibility. Now in alpha release, ThunderHawk SmartPhone Edition enables users to browse the Web on SmartPhones. ThunderHawk PocketPC Edition allows consumers to browse the Web on Pocket PC devices. ThunderHawk Enterprise Server is a client-server technology for corporations and telecommunications companies. Providing wireless Web browsing across networks, it gives a mobile workforce complete access to Internet and corporate intranet Web pages. MyFonts.com is a showcase of the world s fonts available from one easy-to-use Web site. It provides the largest collection of fonts ever assembled for on-line delivery, and offers easy ways to find and purchase fonts on-line. MyFonts.com also offers unique typographic resources and forums for interacting with font experts. Pageflex technologies have pioneered a new direction in composition software: Web-top publishing. Web-top publishing software helps novice users create high-quality printed products using intelligent, flexible templates, without installing or learning any new desktop publishing software.

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Pageflex templates are intelligent and flexible because professional designers can set rules to define which elements can change, how much they can change, and who can change them. Pageflex products thus maintain corporate identity and design integrity while enabling sophisticated customizing of documents

FORWARD LOOKING STATEMENTS

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

The Company is 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 believe that our future results of operations could be affected by various factors, including the following:

- delays in the development or shipment of our new products or new versions of our existing products;
- the introduction of competitive products by others;
- general worldwide economic conditions;
- inability to attract and retain key personnel;
- intellectual property disputes;
- fluctuations in quarterly operating results;
- changes in accounting rules; and
- unanticipated changes in tax rates and regulations.

The computer software market is highly competitive and is characterized by rapid technological change and adoption of new industry standards. As the markets in which the Company s products are sold continue to develop and as the Company enters new markets, the Company expects to continue to face substantial competition from other software developers and anticipates that additional competitors will enter those markets. Many of the Company s competitors or potential competitors have significantly greater financial, marketing and technical resources than the Company. These competitors may be able to adapt more quickly to new or emerging technologies and standards or changes in customer requirements or may be able to devote greater resources to the promotion and sale of their products than the Company. Many of these competitors currently market, or can potentially market, their products directly to the ultimate consumers of such products as part of a broader product offering. There can be no assurance that the Company will be able to compete successfully against these entities. To compete successfully, the Company must continue to invest in research and product development and must devote substantial resources to its marketing and sales functions. There can be no assurance that the Company will have the necessary capital resources to fund such investment. Also, if we are unable to consistently introduce new products, services, and enhancements, our revenue and operating results are likely to decrease. Any failure by the Company to anticipate or respond to new technological developments and customer requirements, or any significant delays in product development or introduction, could have a material adverse effect on the Company s business, financial condition and results of operations. New products, when first released by the Company, may contain undetected errors that, despite quality control measures employed by the Company, are discovered only after a product has been integrated into the OEM and ISV product and used by customers. Such errors may cause delays in product acceptance and may require design modifications which could have a material adverse effect on the Company s business, financial condition and results of operations.

Our business may also be affected by general worldwide economic conditions and related uncertainties affecting markets in which we operate. Adverse economic conditions could adversely impact our business in 2004 and beyond, resulting in: reduced demand for some of our products; increased pressure on the prices for our products and services; and greater difficulty in collecting accounts receivable. For example, revenue from our Type segment s font and font technology product lines decreased during the year ended December 31, 2003 as compared to 2002. The continuing weakness in the economy and aggressive competition among printer manufacturers is contributing to lower average selling prices of printers, which may result in attempts to reduce our royalty arrangements or may cause our printer customers to pursue alternative technologies. To address this issue, we are pursuing a number of strategies to generate revenue growth, including: identifying new markets for our products; developing new applications for our technologies; allocating research and development funding to products with high revenue potential; and strengthening our presence in selected geographic markets. Our investments in our Pageflex and ThunderHawk technologies reflect our commitment to these strategies. Due to limited resources, we may not be able to continue to successfully implement these strategies, which could have a material adverse effect on our business, results of operations and financial condition.

Sales to customers outside the United States represented 20.9% of the Company s revenues for the year ended December 31, 2003. This revenue does not include revenue derived from products sold into the international market by the Company s domestic OEM and ISV customers or foreign purchases downloaded from the Company s Myfonts.com and Bitstream.com Web sites. The Company expects that its international business will continue to account for a significant portion of its future revenues. An increase in the value of the U.S. dollar relative to foreign currencies could make the Company s products more expensive and therefore less competitive in foreign markets. Additional risks inherent in the Company s international business activities generally include unexpected changes in regulatory requirements, tariffs and other trade barriers, longer accounts receivable payment cycles, potentially adverse tax consequences, and the burdens of complying with a wide variety of foreign laws. There can be no assurance that such factors will not have an adverse effect on the Company s future revenues and the Company s results of operations. In addition, the Company s European business is significant and has historically been negatively affected during the three months ended September 30th due to the summer closing or slowdown of several European customers. These seasonal factors have affected, and may continue to affect, the Company s quarterly results of operations.

The Company s performance depends to a significant extent on the continued service of its senior management and key technical employees. The Company s future results will depend upon its ability to attract and retain highly skilled technical, managerial, and marketing personnel. Competition for such personnel in the software industry is intense. We rely on competitive compensation packages to recruit and retain highly skilled employees in a competitive environment, but we do not enter into employment agreements with our personnel. There can be no assurance that the Company will be successful in attracting and retaining the personnel required to sustain its business. Failure to attract and retain such personnel could have a material adverse effect on the Company s business, financial condition and results of operations.

The Company regards its software as proprietary and attempts to protect it with a combination of copyright, patent, trademark, and trade secret laws, employee and third-party nondisclosure agreements and other methods of protection. There can be no assurance that these measures will be adequate or that the Company s competitors

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will not independently develop technologies that are substantially equivalent or superior to the Company s technologies. It may be possible for unauthorized third parties to copy or reverse engineer portions of the Company s products or otherwise obtain and use information that the Company regards as proprietary. Furthermore, the laws of certain foreign countries in which the Company s products are or may be developed, manufactured or sold may not protect the Company s products or intellectual property rights to the same extent as do the laws of the United States and thus make the possibility of unauthorized use of the Company s technologies and products more likely. We also rely on confidentiality agreements with our collaborators, employees, and consultants to protect our trade secrets and proprietary know-how. These agreements may be breached and we may not have adequate remedies for any such breach. In addition, our trade secrets may otherwise become known or be independently developed by our competitors. In connection with the enforcement of our own intellectual property rights or in connection with disputes relating to the validity or alleged infringement of third-party rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation as part of our policy to vigorously defend our intellectual property rights, including rights derived from third-party licensors. Intellectual property disputes and litigation are typically very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Adverse decisions in such litigation or disputes could have negative results, including subjecting us to significant liabilities, requiring us to seek licenses from others, preventing us from making, using, selling, distributing, or marketing our products and services in the United States or abroad, or causing severe disruptions to our operations or the markets in which we compete, any one of which could seriously harm our business. Additionally, although we actively pursue software pirates as part of our enforcement of our intellectual property rights, we do lose revenue due to illegal use of our software. If piracy activities increase, it may further harm our business.

The Company has previously experienced quarter-to-quarter fluctuations in its operating results as a result of a number of factors including the timing of new product introductions, announcements of new products by the Company, its competitors or its customers, slower-than-anticipated growth rates of emerging markets, slower adoption of new products and technologies into which the Company s products are incorporated, delays in customer purchases in anticipation of industry developments, and gross margin fluctuations relating to variations in product mix. Furthermore, a significant portion of the Company s expenses are relatively fixed in nature and the Company may not be able to reduce spending in response to shortfalls or delays in sales. Such shortfalls or delays may result in a material adverse effect on the Company s business, financial condition and results of operations. As a result, the Company believes that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Moreover, the Company does not operate with a significant backlog and often tends to realize a disproportionate share of its revenues in the last few weeks of a fiscal quarter, thereby impairing the Company s ability to accurately forecast quarter-to-quarter sales results. Due to the foregoing factors, it is likely that in one or more future fiscal quarters the Company s operating results may be below the expectations of public market analysts and investors. Such an event could have a material adverse effect on the market price of the Company s Class A Common Stock which could have a negative effect on the Company s ability to obtain additional funding, if necessary, on terms favorable to the Company.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. These principles are subject to interpretation by the American Institute of Certified Public Accountants (the AICPA), the Securities and Exchange Commission (the SEC) the Public Company Accounting Oversight Board (the PCAOB) and various bodies formed to interpret and create appropriate accounting policies. A change in these principles and policies could have a significant effect on our reported results and may even retroactively affect previously reported transactions. For example, a proposed change to the method for accounting for stock options, if adopted, could result in the Company recognizing additional expense upon the grant of such options, which, could have an adverse effect on the Company s financial results. Additionally, to avoid the additional expense resulting from having to expense option grants, the Company may refrain from granting additional options, which may make it more difficult for the Company to attract and retain

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skilled technical, managerial and marketing personnel. Changes to these rules may have a significant adverse effect on future financial results or in the way in which we conduct our business.

Unanticipated changes in tax rates could adversely affect our future results of operations. Increases in tax rates or changes in how taxes are assessed could increase the Company s tax liabilities, which would negatively effect the Company s business and financial results.

RESULTS OF OPERATIONS

Certain prior year account balances have been reclassified to be consistent with the current year s presentation. The following table sets forth the percentage of revenue represented by certain items reflected in the Company s Statements of Operations Data for the periods presented:

	Years Ended December 31,		
	2003	**2002**	**2001**
Revenue			
Software licenses	87.3%	87.6%	86.1%
Services	12.7	12.4	13.9
Total revenue	100.0	100.0	100.0
Cost of revenue			
Software licenses	25.5	19.9	13.4
Services	5.5	4.4	4.5
Total cost of revenue	31.0	24.3	17.9
Gross profit	69.0	75.7	82.1
Operating expenses:			
Marketing and selling	27.3	26.3	36.8
Research and development	39.4	47.5	63.3
General and administrative	20.5	17.1	23.3
Total operating expenses	87.2	90.9	123.4
Operating loss	(18.2)	(15.2)	(41.3)
Other income (expense), net	6.6	2.6	(0.3)
Benefit from (Provision for) income taxes	(0.8)	0.5	(2.1)
Net loss	(12.4)%	(12.1)%	(43.7)%

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YEAR ENDED DECEMBER 31, 2003 COMPARED TO THE YEAR ENDED DECEMBER 31, 2002

(in thousands except percent amounts)

Consolidated Gross Profit:

	DECEMBER 31,				Change	
	2003	% of Revenue	2002	% of Revenue	Dollars	Percent
Revenue						
Software licenses	$ 8,487	87.3%	$ 7,415	87.6%	$ 1,072	14.5%
Services	1,239	12.7	1,052	12.4	187	17.8
Total revenue	9,726	100.0	8,467	100.0	1,259	14.9
Cost of Revenue						
Software licenses	2,477	29.2	1,682	22.7	795	47.3
Services	540	43.6	372	35.4	168	45.2
Total cost of revenue	3,017	31.0	2,054	24.3	963	46.9
Gross Profit	$ 6,709	69.0%	$ 6,413	75.7%	$ 296	4.6%

The increase in revenue for the year ended December 31, 2003 as compared to the year ended December 31, 2002 was attributable to an increase in revenue in the Company s MyFonts and Pageflex segments of $1,020 and $899, respectively, partially offset by a decrease in Type segment revenue of $660. Cost of revenue increased for the same periods due to increased royalty expense for the Company s MyFonts and Pageflex segments and increased service costs for the Type segment. Cost of revenue for the Company includes royalties and fees paid to third parties for the development or license of rights to technology and/or unique typeface designs, costs incurred in the fulfillment of custom orders, and costs associated with the duplication, packaging and shipping of product. Gross profit generated by each segment is discussed in more detail below.

Type Gross Profit:

	DECEMBER 31,				Change	
	2003	% of Segment Revenue	2002	% of Segment Revenue	Dollars	Percent
Revenue						
Software licenses	$ 3,597	91.3%	$ 4,249	92.4%	$ (652)	(15.3)%

Services	344	8.7	352	7.6	(8)	(2.3)
Total revenue	3,941	100.0	4,601	100.0	(660)	(14.3)
Percentage of total revenue	40.5%		54.3%			
Cost of Revenue						
Software licenses	367	10.2	477	11.2	(110)	(23.1)
Services	301	87.5	150	42.6	151	100.7
Total cost of revenue	668	17.0	627	13.6	41	6.5
Gross Profit	$ 3,273	83.0%	$ 3,974	86.4%	$ (701)	(17.6)%

The decrease in revenue for the year ended December 31, 2003 as compared to the year ended December 31, 2002 was primarily the result of a decrease in OEM license revenue of $489, a decrease in retail font product sales of $206 and a decrease in revenue from custom design services of $8, partially offset by an increase in retail ThunderHawk sales of $42. Retail sales of the Company s Type products and custom design work have decreased during the past year because of consumer concerns about the economy and decreases in spending on

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development efforts by high-technology customers. Cost of licenses for the same periods has decreased primarily because of the decrease in revenue, while cost of services increased primarily due to costs incurred upon the establishment of a service and support structure for the Company s browser technology during 2003.

The Company s Type business recognizes font license revenue from the resale of its font products through various resellers. Resellers have an electronic digital format of the company s font products available to them through the Bitstream Manufacturing System (BMS). This system is installed on their servers and allows them to manufacture a font for sale to a customer. The BMS system tracks the fonts sold and generates a monthly sales report, which is sent by the reseller to Bitstream. Revenue is recognized 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.

MyFonts Gross Profit:

	DECEMBER 31,					
					Change	
	2003	% of Segment Revenue	2002	% of Segment Revenue	Dollars	Percent
Revenue						
Software licenses	$ 2,398	100.0 %	$ 1,378	100.0 %	$ 1,020	74.0 %
Total revenue	2,398	100.0	1,378	100.0	1,020	74.0
Percentage of total revenue	24.7%		16.3%			
Cost of Revenue						
Software licenses	1,885	78.6	1,121	81.4	764	68.2
Total cost of revenue	1,885	78.6	1,121	81.4	764	68.2
Gross Profit	$ 513	21.4 %	$ 257	18.6 %	$ 256	99.6 %

MyFonts continued to be successful in increasing the number of fonts available on its Web site, the number of foundries participating, and the number of consumer accounts. Myfonts has attracted new purchasers while also retaining existing customers. Existing customers accounted for approximately 30% of orders during 2003 and 2002. Inter-company sales, which MyFonts generated from the resale of Bitstream fonts, have been excluded. Cost of revenue increased primarily due to an increase in royalties and referrer fees due to increased revenue, and an increase in shipping, packaging and handling costs due to the increase in products sold that must be physically shipped. Cost of revenue as a percentage of sales, however has decreased as the Company has negotiated lower royalty percentages to be paid to third party foundries and because of a lower royalty paid on sales of CD products.

MyFonts currently recognizes revenue from referral agreements (Level 1 agreements) and resale agreements (Level 2 agreements). Referral revenue for year ended December 31, 2003 was $14 versus $13 for the year ended December 31, 2002. All other revenue recognized by MyFonts resulted from Level 2 agreements under which MyFonts sells the fonts directly from its site(s). There are only minimal costs to the Level 1 program, which represent the time to load copies of the fonts provided by each participating foundry for addition to the MyFonts database, and the Company expenses those costs as incurred.

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Pageflex Gross Profit:

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2003	Revenue	2002	Revenue	Dollars	Percent
Revenue						
Software licenses	$ 2,492	73.6 %	$ 1,788	71.9 %	$ 704	39.4 %
Services	895	26.4	700	28.1	195	27.9
Total revenue	3,387	100.0	2,488	100.0	899	36.1
Percentage of total revenue	34.8%		29.4%			
Cost of Revenue						
Software licenses	225	9.0	84	4.7	141	167.9
Services	239	26.7	222	31.7	17	7.7
Total cost of revenue	464	13.7	306	12.3	158	51.6
Gross Profit	$ 2,923	86.3 %	$ 2,182	87.7 %	$ 741	34.0 %

The increase in Pageflex revenue for the year ended December 31, 2003 as compared to the year ended December 31, 2002 was due to increases in direct license sales and services of $845, and reseller license sales and services of $75, partially offset by decreases in OEM related sales and services of $21. The increase in cost of license revenue is primarily due to the recording of royalty expenses attributable to a pending settlement agreement with a Pageflex vendor. Cost of service revenue increased $17 but has decreased as a percentage of service revenue as Pageflex s existing infrastructure has been able to satisfy the demands of the increased customer base.

The Company licenses its Pageflex products directly to Web-to-print providers, print service providers, major corporations and end users, and indirectly through resellers and strategic partners. During 2003, revenue from direct sales and services was $2,849 and revenue from resellers and OEM relationships totaled $538.

Marketing and Selling:

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2003	Revenue	2002	Revenue	Dollars	Percent
Type	$ 1,444	36.6 %	$ 1,218	26.5 %	$ 226	18.6 %

MyFonts	42	1.8	39	2.8	3	7.7
Pageflex	1,167	34.5	972	39.1	195	20.1
Consolidated marketing and selling	$ 2,653	27.3 %	$ 2,229	26.3 %	$ 424	19.0 %

Type marketing and selling expenses increased primarily due to the hiring of dedicated sales resources for ThunderHawk, participation in wireless tradeshows, and print advertising for ThunderHawk totaling $271 for the year ended December 31, 2003. This increase was partially offset by decreases in font and font technology sales and marketing expenses due to decreased participation in non-ThunderHawk trade shows and variable expenses such as commissions, which decreased as the sales volume for font products has decreased. Pageflex marketing and selling expenses increased primarily due to costs associated with the addition of three independent sales representatives engaged at the end of 2002, an increase in trade show participation, and an increase in travel-related expenses, which increased expenses $181 for the year ended December 31, 2003 as compared to the year ended December 31, 2002. MyFonts sales and marketing activities and initiatives have remained relatively unchanged during the years ended December 31, 2002 and 2003.

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Research and Development (R&D):

	DECEMBER 31,					
					Change	
	2003	% of Segment Revenue	2002	% of Segment Revenue	Dollars	Percent
Type	$ 1,590	40.3 %	$ 1,868	40.6 %	$ (278)	(14.9)%
MyFonts	567	23.6	503	36.5	64	12.7
Pageflex	1,669	49.3	1,657	66.6	12	0.7
Consolidated research and development	$ 3,826	39.4 %	$ 4,028	47.5 %	$ (202)	(5.0)%

Type R&D expenses decreased for the year ended December 31, 2003 as compared to the year ended December 31, 2002 primarily because of decreases in both internal personnel and outside contractor development on the Company s font products totaling $127, a decrease in the use of customer support personnel for font R&D projects of $77, decreases in facility and depreciation charges due to the decrease in font personnel totaling $56 and from an increase in charges to the MyFonts and Pageflex segments for increased utilization of Type personnel of $25 and $35, respectively. This decrease in R&D expenses was partially offset by an increase in development costs for ThunderHawk of $27. The increase in MyFonts R&D expense for the year ended December 31, 2003 as compared to the year ended December 31, 2002 was primarily due to an increase in employee-related costs resulting from a higher utilization of Type resources of $25 and internet access at a co-location site of $18, combined with the non-recurrence of credits of $26 realized in the year ended December 31, 2002 for variable accounting treatment of stock options granted to non-employee consultants. The increase in Pageflex R&D expenses for the year ended December 31, 2003 as compared to the year ended December 31, 2002 included $19 in increased personnel-related costs and $35 from a higher utilization of Type resources for internal Mpower development efforts, partially offset by a decrease in facility related expenses of $30.

General and Administrative (G&A):

	DECEMBER 31,					
					Change	
	2003	% of Segment Revenue	2002	% of Segment Revenue	Dollars	Percent
Type	$ 998	25.3%	$ 839	18.2%	$ 159	19.0%
MyFonts	206	8.6	90	6.5	116	128.9
Pageflex	793	23.4	517	20.8	276	53.4
Consolidated general and administrative	$ 1,997	20.5%	$ 1,446	17.1%	$ 551	38.1%

The increase in G&A expenses for the year ended December 31, 2003 as compared to the year ended December 31, 2002 included approximately $72 in expenses incurred to relocate the Company s offices, $260 in legal expenses including expenses incurred to defend against certain trademark infringement lawsuits, combined with the non-recurrence of a credit of $118 realized in the year ended December 31, 2002 for a change in an estimate associated with the Company s sale of two product lines to Inso Corporation in August 1998. G&A expenses are primarily allocated to the business segments based on headcount. In addition, G&A expenses for MyFonts during the year ended December 31, 2003 included $82 in legal expenses incurred to defend against a trademark infringement lawsuit filed against MyFonts in 2003, which was settled in November 2003.

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Gain on Investment in DiamondSoft, Inc.:

	DECEMBER 31,					
					Change	
	2003	% of Revenue	2002	% of Revenue	Dollars	Percent
Gain on investment in DiamondSoft, Inc.	$ 591	6.1%	$ 149	1.8%	$ 442	296.6%

On March 13, 1998, the Company made a $500 or 25% equity investment, accounted for under the equity method, in DiamondSoft, Inc. (DiamondSoft), a California corporation primarily engaged in the business of developing, marketing and distributing software tools to a variety of professional markets. During the year ended December 31, 2001 the Company made additional investments totaling $410 in DiamondSoft, resulting in an increase in Bitstream s ownership percentage to 31.7% at December 31, 2001, which remained unchanged until July 1, 2003. On July 1, 2003, in connection with the acquisition of DiamondSoft by Extensis, a wholly owned subsidiary of Celartem Technology USA, Inc., the Company sold its shares in DiamondSoft to Extensis in a cash transaction resulting in a realized and recognized gain on its investment of $399. The Company s investment in DiamondSoft as of the June 30, 2003 Balance Sheet was $940 and the Company received $1,339 in cash from this transaction on July 1, 2003. The gain above represents the Company s pro rata share of DiamondSoft s net income and the gain realized on the sale of the Company s investment. Further discussion can be found in Note 3 in the Notes to the Consolidated Financial Statements included herewith.

Interest and other income, net:

	DECEMBER 31,					
					Change	
	2003	% of Revenue	2002	% of Revenue	Dollars	Percent
Interest and other income, net	$ 48	0.5%	$ 74	0.9%	$ (26)	(35.1)%

Interest and other income consists primarily of income earned on cash and money market instruments and has decreased as the Company has used cash to fund operations and also as interest rates have decreased.

Provision for income taxes:

DECEMBER 31,

	2003	% of Revenue	2002	% of Revenue	Change Dollars	Change Percent
Income tax (benefit) provision	$ 77	0.8%	$ (45)	(0.5)%	$ 122	271.1%

The Company s tax provision for the year ended December 31, 2003 was primarily due to foreign withholding taxes. The Company s tax benefit for the year ended December 31, 2002 resulted from US federal and state refunds of $141 of taxes paid in prior years. This benefit was partially offset by foreign taxes totaling $96. Foreign taxes vary with Type OEM license royalties from customers in countries who have signed tax conventions with the United States including Japan, Korea, and Poland, and also with the results of operations from the Company s location in the United Kingdom, which was closed as of March 31, 2003.

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YEAR ENDED DECEMBER 31, 2002 COMPARED TO THE YEAR ENDED

DECEMBER 31, 2001

(in thousands except percent amounts)

Consolidated Gross Profit:

	DECEMBER 31,					
		% of		% of	Change	
	2002	Revenue	2001	Revenue	Dollars	Percent
Revenue						
Software licenses	$ 7,415	87.6 %	$ 6,859	86.1 %	$ 556	8.1 %
Services	1,052	12.4	1,109	13.9	(57)	(5.1)
Total revenue	8,467	100.0	7,968	100.0	499	6.3
Cost of Revenue						
Software licenses	1,682	22.7	1,071	15.6	611	57.1
Services	372	35.4	356	32.1	16	4.5
Total cost of revenue	2,054	24.3	1,427	17.9	627	43.9
Gross Profit	$ 6,413	75.7 %	$ 6,541	82.1 %	$ (128)	(2.0)%

The increase in revenue for the year ended December 31, 2002 as compared to the year ended December 31, 2001 was attributable to an increase in revenue in the Company s MyFonts and Pageflex segments of $868 and $378, respectively, partially offset by a decrease in Type segment revenue of $747. The increase in cost of revenue for the same periods was due to increased royalty expense for the Company s MyFonts segment resulting from increased sales. Cost of revenue for the Company includes royalties and fees paid to third parties for the development or license of rights to technology and/or unique typeface designs, costs incurred in the fulfillment of custom orders, and costs associated with the duplication, packaging and shipping of product. Gross profit generated by each segment is discussed in more detail below.

Type Gross Profit:

DECEMBER 31,					
	% of Segment		% of Segment	Change	
2002	Revenue	2001	Revenue	Dollars	Percent

Revenue						
Software licenses	$ 4,249	92.4 %	$ 4,886	91.4 %	$ (637)	(13.0)%
Services	352	7.6	462	8.6	(110)	(23.8)
Total revenue	4,601	100.0	5,348	100.0	(747)	(14.0)
Percentage of total revenue	54.3%		67.1%			
Cost of Revenue						
Software licenses	477	11.2	516	10.6	(39)	(7.6)
Services	150	42.6	204	44.2	(54)	(26.5)
Total cost of revenue	627	13.6	720	13.5	(93)	(12.9)
Gross Profit	$ 3,974	86.4 %	$ 4,628	86.5 %	$ (654)	(14.1)%

The decrease in Type revenue for the year ended December 31, 2002 as compared to the year ended December 31, 2001 was primarily the result of a decrease in OEM license revenue of $619, a decrease in retail product sales of $17 and a decrease in revenue from custom design services of $110. Retail sales of the Company s Type products and custom design work have decreased during the past year because of consumer

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concerns about the economy and decreases in spending, on development efforts by high-technology customers. Cost of revenue for the same periods has decreased primarily because of the decrease in revenue.

MyFonts Gross Profit:

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2002	Revenue	2001	Revenue	Dollars	Percent
Revenue						
Software licenses	$ 1,378	100.0 %	$ 510	100.0 %	$ 868	170.2 %
Total revenue	1,378	100.0	510	100.0	868	170.2
Percentage of total revenue	16.3%		6.4%			
Cost of Revenue						
Software licenses	1,121	81.4	395	77.5	726	183.8
Total cost of revenue	1,121	81.4	395	77.5	726	183.8
Gross Profit	$ 257	18.6 %	$ 115	22.5 %	$ 142	123.5 %

MyFonts has been successfully increasing the number of fonts available on its site and the number of foundries participating. In August 2002, MyFonts enhanced its Web site making it easier for customers to navigate within the site and find the fonts in which they are interested. Myfonts has attracted new purchasers while also retaining existing customers. Existing customers accounted for approximately 25% to 30% of orders during 2002. Inter-company sales, which MyFonts generated from the resale of Bitstream fonts, have been excluded. Cost of revenue increased primarily due to an increase in sales of fonts from non-affiliated foundries, increased referrer fees and expenses associated with the implementation of selling products that must be physically shipped on the Company s Web site. Royalties payable to non-affiliated foundries on sales of their fonts represented approximately 80% of the revenue generated.

Pageflex Gross Profit:

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2002	Revenue	2001	Revenue	Dollars	Percent
Revenue						
Software licenses	$ 1,788	71.9 %	$ 1,463	69.3 %	$ 325	22.2 %

Services	700	28.1	647	30.7	53	8.2
Total revenue	2,488	100.0	2,110	100.0	378	17.9
Percentage of total revenue	29.4%		26.5%			
Cost of Revenue						
Software licenses	84	4.7	160	10.9	(76)	(47.5)
Services	222	31.7	152	23.5	70	46.1
Total cost of revenue	306	12.3	312	14.8	(6)	(1.9)
Gross Profit	$ 2,182	87.7 %	$ 1,798	85.2 %	$ 384	21.4 %

The increase in Pageflex revenue for the year ended December 31, 2002 as compared to the year ended December 31, 2001 was due to increases in direct and reseller license sales and services of $390 and $199, respectively, partially offset by decreases in OEM related sales and services of $65 and $146, respectively. Since late in 2001, Pageflex has focused on product sales and services rather than OEM sales and related non-recurring

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development revenue. The decrease in cost of revenue for the year ended December 31, 2002 as compared to the year ended December 31, 2001 was primarily attributable to a decrease in direct costs of $85 partially offset by increased payroll costs resulting from the reassignment of two employees to provide support and infrastructure to the Company s increased customer base during the first quarter of 2002.

Marketing and Selling:

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2002	Revenue	2001	Revenue	Dollars	Percent
Type	$ 1,218	26.5 %	$ 1,507	28.2 %	$ (289)	(19.2)%
MyFonts	39	2.8	64	12.5	(25)	(39.1)
Pageflex	972	39.1	1,356	64.3	(384)	(28.3)
Consolidated marketing and selling	$ 2,229	26.3 %	$ 2,927	36.8 %	$ (698)	(23.8)%

The decrease in marketing and selling expenses for the year ended December 31, 2002 as compared to the year ended December 31, 2001 reflects expense reductions implemented by management in the fourth quarter of 2001. Type marketing and selling expenses decreased primarily due to a decrease in trade show expenses of $45, a decrease in miscellaneous advertising and printing costs of $20, and a decrease in employee-related costs of $167, combined with a currency exchange gain from the sales office in the UK of $48. Pageflex marketing and selling expenses decreased primarily due to decreases in employee head-count related expenses, outside consulting expenses, and trade show expenses of $272, $34 and $44, respectively. Myfonts marketing and selling expenses decreased primarily due to a decrease in print advertising expenses of $25 for the year ended December 31, 2002 as compared to the year ended December 31, 2001.

Research and Development (R&D):

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2002	Revenue	2001	Revenue	Dollars	Percent
Type	$ 1,868	40.6 %	$ 1,776	33.2 %	$ 92	5.2 %
MyFonts	503	36.5	706	138.4	(203)	(28.8)
Pageflex	1,657	66.6	2,562	121.4	(905)	(35.3)
Consolidated research and development	$ 4,028	47.5 %	$ 5,044	63.3 %	$ (1,016)	(20.1)%

The decrease in R&D expenses for the year ended December 31, 2002 as compared to the year ended December 31, 2001 is primarily attributable to cost reductions adopted during the fourth quarter of 2001. This decrease was partially offset by an increase Type R&D expense, which was primarily due to an increase in internally allocated resources and outside consulting fees for product development, relating to the Company s new ThunderHawk wireless browser, of $160, and increased facility charges of $92. This increase was partially offset by a decrease in goodwill amortization associated with the acquisition of Type Solutions, Inc. of $119, resulting from the Company s adoption of SFAS No. 142 effective January 1, 2002. See Note 1(j) in the Notes to the Consolidated Financial Statements included herewith. The decrease in MyFonts R&D expense for the year ended December 31, 2002 as compared to the year ended December 31, 2001 was primarily the result of the decreased use of outside consultants and the absorption of that work by Company employees which resulted in savings of approximately $257 partially offset by increased facility-related charges of $27 over the same period. The decrease in Pageflex R&D expense over the same periods was primarily attributable to employee headcount reductions, which resulted in savings of $531. The Pageflex segment reassigned two employees to customer support positions, which are included in cost of revenue, and decreased R&D expense over the same periods by

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$106. Pageflex also decreased the outsourcing of engineering projects, which resulted in savings of $122 for the year ended December 31, 2002 as compared to the year ended December 31, 2001.

General and Administrative (G&A):

	DECEMBER 31,					
		% of Segment		% of Segment	Change	
	2002	Revenue	2001	Revenue	Dollars	Percent
Type	$ 839	18.2				