LIBERATE TECHNOLOGIES
Form 10-Q/A
September 16, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A
Amendment No. 1

(Mark one)

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

For the quarterly period ended NOVEMBER 30, 2001

OR

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

For the transition period from to
Commission File Number 000-26565

LIBERATE TECHNOLOGIES

(Exact name of registrant as specified in its charter)

Delaware	**94-3245315**
(State or Other Jurisdiction of Incorporation)	(I.R.S. Employer Identification No.)
2 Circle Star Way, San Carlos, California	**94070-6200**
(Address of principal executive office)	(Zip Code)

(650) 701-4000
(Registrant's telephone number, including area code)

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 twelve 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 o No ý

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

106,563,593 shares of the Registrant's common stock were outstanding as of December 31, 2001.

EXPLANATORY NOTE

Liberate Technologies is filing this amended quarterly report on Form 10-Q/A for the quarter ended November 30, 2001 in order to amend and restate the items described below, which were originally presented in Liberate's quarterly report on Form 10-Q filed with the Securities and Exchange Commission on January 14, 2002. This Amendment No. 1 amends the following items of the original report on Form 10-Q:

We are amending Part I, Item 1, "Financial Statements," to reflect the restatement of Liberate's unaudited Condensed Consolidated Financial Statements, as of November 30, 2001, and for the three-month and six-month periods then ended and the application of EITF 01-09 and 01-14;

We are amending Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," to take into account the effects of the restatement; and

We are amending Part II, Item 6, "Exhibits and Reports on Form 8-K," to include the certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

In order to preserve the nature and character of the disclosures set forth in the items as originally filed, this Amendment No. 1 does not reflect other events that occurred after the filing of our original report on Form 10-Q on January 14, 2002, or modify or update the disclosures presented in the original report, except for the amendments described above.

For current disclosure, more information regarding the restatement of our financial statements and related litigation and investigations, and a discussion of subsequent events and anticipated trends please see our amended Annual Report on Form 10-K/A for the fiscal year ended May 31, 2002 our quarterly reports on Form 10-Q for the quarters ended August 31, 2002, November 30, 2002, and February 28, 2003 and our Annual Report on Form 10-K for the fiscal year ended May 31, 2003, which we are filing concurrently with this Amendment No. 1.

LIBERATE TECHNOLOGIES
FORM 10-Q/A, Amendment No. 1
For The Quarter Ended November 30, 2001

TABLE OF CONTENTS

Part I. Financial Information

Item 1. Financial Statements, as Restated

LIBERATE TECHNOLOGIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
Unaudited

	May 31, 2001	November 30, 2001
		(As restated)
Assets		
Current assets:		
Cash and cash equivalents	$ 126,989	$ 138,005
Short-term investments	149,161	97,813
Accounts receivable, net	11,055	8,552
Receivable from affiliate, net	174	174
Prepaid expenses and other current assets	8,955	6,575
Total current assets	296,334	251,119
Property and equipment, net	19,085	16,559
Purchased intangibles, net	432,223	321,802
Restricted cash	8,788	9,190
Long-term investments	184,757	205,207
Warrants	83,243	26,962
Notes receivable from officers	1,534	1,579
Other	511	558
Total assets	$ 1,026,475	$ 832,976
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,699	$ 2,536
Accrued liabilities	13,389	14,775
Accrued payroll and related expenses	5,083	6,133
Current portion of capital lease obligations	672	605
Deferred revenues	54,216	40,164
Total current liabilities	75,059	64,213
Capital lease obligations, net of current portion	389	67
Other long-term liabilities	1,345	6,060
Total liabilities	76,793	70,340

	May 31, 2001	November 30, 2001
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock	1,047	1,061
Contributed and paid-in capital	1,428,110	1,433,314
Warrants	59,897	59,897
Deferred stock compensation	(3,087)	(2,437)
Accumulated other comprehensive income	636	666
Accumulated deficit	(536,921)	(729,865)
Total stockholders' equity	949,682	762,636
Total liabilities and stockholders' equity	$ 1,026,475	$ 832,976

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

LIBERATE TECHNOLOGIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE LOSS
(In thousands, except per share data)
Unaudited

	Three months ended November 30,		Six months ended November 30,	
	2000	**2001**	**2000**	**2001**
		(As restated)		**(As restated)**
Revenues:				
License and royalty(1)	$ 563	$ 8,584	$ (907)	$ 17,414
Service(2)	6,278	9,591	11,380	18,017
Total revenues	6,841	18,175	10,473	35,431
Cost of revenues:				
License and royalty	650	550	1,261	1,028
Service(2)	6,376	10,114	11,983	19,558
Total cost of revenues	7,026	10,664	13,244	20,586
Gross margin	(185)	7,511	(2,771)	14,845

	Three months ended November 30,		Six months ended November 30,	
Operating expenses:				
Research and development	11,416	10,951	23,510	23,472
Sales and marketing	5,717	6,346	10,741	12,949
General and administrative	2,637	3,050	5,219	6,441
Amortization of purchased intangibles	55,288	55,211	105,549	110,421
Warrant-related asset impairment		44,840		44,840
Amortization of warrants(1)	558	4,782	558	9,493
Excess facilities charges and related asset impairment				7,479(3)
Amortization of deferred stock compensation	476	630	975	1,064
Acquired in-process research and development			22,425	
Total operating expenses	76,092	125,810	168,977	216,159
Loss from operations	(76,277)	(118,299)	(171,748)	(201,314)
Interest income	8,292	4,217	15,948	9,567
Other expense, net	(369)	(679)	(569)	(792)(3)
Loss before income tax provision	(68,354)	(114,761)	(156,369)	(192,539)
Income tax provision		186	204	405
Net loss	(68,354)	(114,947)	(156,573)	(192,944)
Foreign currency translation adjustment	214	235	392	30
Comprehensive loss	$ (68,140)	$ (114,712)	$ (156,181)	$ (192,914)
Basic and diluted net loss per share	$ (0.66)	$ (1.09)	$ (1.55)	$ (1.83)
Shares used in computing basic and diluted net loss per share	103,047	105,805	100,744	105,403

(1) We have reclassified these amounts in accordance with EITF 01-09. See Note 1.

(2) We have reclassified these amounts in accordance with EITF 01-14. See Note 1.

(3) We have reclassified certain amounts for the six months ended November 30, 2001.

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

LIBERATE TECHNOLOGIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
Unaudited

	Six months ended November 30, 2000	Six months ended November 30, 2001 (As restated)
Cash flows from operating activities:		
Net loss	$ (156,573)	$ (192,944)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of purchased intangibles	105,549	110,421
Warrant-related asset impairment		44,840
Amortization of warrants	11,767	11,441
Depreciation and amortization	2,385	4,387
Non-cash compensation expense	975	1,064
Loss on disposal of property and equipment		794
Long-lived asset impairment charge		503
Provision for doubtful accounts		62
Write-off of acquired in-process research and development	22,425	
Changes in operating assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	(3,322)	2,441
Decrease in receivable from affiliate, net	140	
(Increase) decrease in prepaid expenses and other current assets	(1,327)	2,380
(Increase) decrease in notes receivable from officers and other assets	261	(92)
Increase in accounts payable	377	837
Increase (decrease) in accrued liabilities	(6,206)	1,386
Increase (decrease) in accrued payroll and related expenses	(516)	1,050
Decrease in deferred revenues	(10,257)	(14,052)
Increase in other long-term liabilities	357	4,715
Net cash used in operating activities	(33,965)	(20,767)
Cash flows from investing activities:		
Proceeds from maturities of investments	127,664	243,680
Purchase of investments	(183,083)	(212,032)
Purchases of property and equipment	(3,678)	(3,158)
Purchase of equity investments	(3,000)	(750)
Increase in restricted cash		(402)
Issuance of note receivable	(1,994)	
Cash acquired in MoreCom acquisition	1,500	
Net cash provided by (used in) investing activities	(62,591)	27,338
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	4,181	4,804
Principal payments on capital lease obligations	(337)	(389)
Proceeds from private placement, net	100,000	

	Six months ended November 30,	
Net cash provided by financing activities	103,844	4,415
Effect of exchange rate changes on cash	392	30
Net increase in cash and cash equivalents	7,680	11,016
Cash and cash equivalents, beginning of period	132,962	126,989
Cash and cash equivalents, end of period	$ 140,642	$ 138,005

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

LIBERATE TECHNOLOGIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Liberate Technologies and its wholly owned subsidiaries (collectively, "Liberate" or "the Company"). All intercompany accounts and transactions have been eliminated in consolidation. These interim financial statements are unaudited and reflect all adjustments that are, in the opinion of management, necessary to provide a fair statement of financial position and the results of operations for the interim periods in accordance with the rules and regulations of the Securities and Exchange Commission. However, these statements omit certain information and footnote disclosures necessary to conform to generally accepted accounting principles. These statements should be read in conjunction with the audited consolidated financial statements and notes to consolidated financial statements included in Liberate's Form 10-K filed with the Securities and Exchange Commission on August 24, 2001. The results of operations for the interim periods reported herein do not necessarily indicate the results expected for the full fiscal year or for any future period.

Computation of Basic and Diluted Net Loss Per Share

Basic net loss per share is computed using the weighted average number of shares of common stock outstanding. Potential common shares from the exercise of stock options and warrants are excluded from the calculation of basic net loss per share because including them would be anti-dilutive. As of November 30, 2000 and 2001, approximately 18,173,408 and 20,587,444 potential shares were not included in the calculation on this basis.

Recent Accounting Pronouncements

In November 2001, the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force ("EITF") reached consensus on EITF No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer or Reseller of the Vendor's Products." EITF 01-09 generally requires that consideration, including equity instruments, given to a customer be classified in a vendor's financial statements not as an expense, but as an offset to revenue up to the amount of cumulative revenue recognized or to be recognized. While Liberate is required to adopt this new standard no later than the quarter ending May 31, 2002, it plans to adopt this standard for its quarter ending February 28, 2002. In accordance with the transition guidance, adoption will require the reclassification of financial statements for prior periods presented for comparative purposes. Liberate's reclassification of warrant amortization expense under EITF 01-09 will not affect basic and diluted net loss per share, although reclassification will change the presentation of certain revenue and expense items contained within Liberate's financial statements. See "Reclassifications" below.

In October 2001, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment of Long-lived Assets" ("SFAS 144"). SFAS 144 supersedes the accounting and reporting provisions of SFAS No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed Of" ("SFAS 121"), and APB Opinion No. 30, "Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring

Events and Transactions". The Company will adopt SFAS 144 for the fiscal year beginning June 1, 2002.

Effect of Recent Accounting Pronouncement

Effective June 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which establishes accounting and reporting standards for derivative financial instruments and hedging activities related to those instruments, as well as other hedging activities. The adoption of SFAS 133 did not materially impact the Company's financial position, results of operations, or cash flows.

Reclassifications

Effective December 1, 2001, we adopted EITF 01-09. In accordance with the transition guidance in EITF 01-09, adoption required the reclassification of financial statement presentations for prior periods presented for comparative purposes. Adopting EITF 01-09 did not affect our basic and diluted net loss per share, financial position, results of operations, or cash flows. The reclassification did affect the presentation of certain revenue and expense items contained within our financial statements by reducing revenues and expenses by corresponding amounts.

In January 2002, the FASB issued EITF 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred," which generally requires that a company recognize as revenue travel expenses and other reimbursable expenses billed to customers. We adopted EITF 01-14 effective December 1, 2001, and in accordance with the transition guidance, for comparative purposes, we reclassified our financial statement presentations for prior periods. Adopting EITF 01-14 did not affect our basic and diluted net loss per share, financial position, results of operations, or cash flows. The reclassification did affect the presentation of certain revenue and expense items contained within our financial statements.

Total revenues for the periods reported, including the effects of EITF 01-09 and 01-14, were as follows (in thousands):

	Three months ended November 30,		Six months ended November 30,	
	2000	2001	2000	2001
		(As restated)		(As restated)
License and royalty revenues before the adoption of EITF 01-09	$ 5,726	$ 9,523(1)	$ 10,302	$ 19,362(1)
Impact of EITF 01-09	(5,163)	(939)	(11,209)	(1,948)
License and royalty revenues	$ 563	$ 8,584	$ (907)	$ 17,414
Service revenues before the adoption of EITF 01-14	$ 6,002	$ 9,286(2)	$ 10,830	$ 17,537(2)
Impact of EITF 01-14	276	305	550	480
Service revenues	$ 6,278	$ 9,591	$ 11,380	$ 18,017
Total revenues	$ 6,841	$ 18,175	$ 10,473	$ 35,431

(1)

We have reduced the amounts originally presented in our quarterly report on Form 10-Q filed on January 14, 2002 by $736,000 to reflect the restatement of our financial statements. See Note 2.

(2)

We have reduced the amounts originally presented in our quarterly report on Form 10-Q filed on January 14, 2002 by $1.5 million to reflect the restatement of our financial statements. See Note 2.

5

Cost of service revenues for the periods reported, including the effects of EITF 01-14 were as follows (in thousands):

	Three months ended November 30,		Six months ended November 30,	
	2000	2001	2000	2001
		(As restated)		(As restated)
Cost of service revenues before the adoption of EITF 01-14	$ 6,100	$ 9,809(1)	$ 11,433	$ 19,078(1)
Impact of EITF 01-14	276	305	550	480
Cost of service revenues	$ 6,376	$ 10,114	$ 11,983	$ 19,558

(1) We have increased the amounts originally presented in our quarterly report on Form 10-Q filed on January 14, 2002 by $68,000 to reflect the restatement of our financial statements. See Note 2.

Amortization of warrants (included in operating expenses) for the periods reported including the effects of EITF 01-09 was as follows (in thousands):

	Three months ended November 30,		Six months ended November 30,	
	2000	2001	2000	2001
		(As restated)		(As restated)
Amortization of warrants before the adoption of EITF 01-09	$ 5,721	$ 5,721	$ 11,767	$ 11,441
Impact of EITF 01-09	(5,163)	(939)	(11,209)	(1,948)
Amortization of warrants	$ 558	$ 4,782	$ 558	$ 9,493

Certain reclassifications have been made to previously reported amounts in the condensed consolidated financial statements in order to conform to current period presentations.

Note 2. Restatement of Liberate's Financial Statements for the Period Ended November 30, 2001

On October 15, 2002, we announced that we would restate our financial results for our fourth quarter and fiscal year ended May 31, 2002 and delay the filing of our quarterly report on Form 10-Q for the quarter ended August 31, 2002. We made this determination after discovering facts calling into question the appropriateness and timing of revenue recognition for a single-transaction license fee of approximately $1.8 million. Our audit committee, which is composed of independent outside directors, retained independent counsel to review the revenue reported during our fiscal year ended May 31, 2002. On November 21, 2002, we announced that we had discovered facts that called into question the appropriateness and timing of revenue recognition for various transactions (including the originally identified transaction) that accounted for a total of approximately $10 million in revenue during our 2002 fiscal year and the first quarter of our 2003 fiscal year. Our audit committee and its independent advisors concluded that our historical financial statements had overstated our revenues by $9.9 million for fiscal 2002. While our audit committee's investigation was pending, we were not able to file our quarterly reports on Form 10-Q, and as a result, our stock was delisted from the Nasdaq National Market in January 2003 and currently trades through the Pink Sheets system.

As a result of our audit committee's investigation, we are restating our financial statements as of, and for the fiscal year ended, May 31, 2002. We are also restating our financial statements as of, and for the quarters ended November 30, 2001, February 28, 2002, and May 31, 2002. We are including the restated results for the quarter ended November 30, 2001 in this report and we are filing an amended quarterly report on Form 10-Q/A for the quarter ended February 28, 2002 and an Annual Report on

Form 10-K/A for the year ended May 31, 2002. We are also revising the preliminary results and financial statements for the quarter ended August 31, 2002 that we disclosed in a press release dated September 26, 2002 and including those revised results in a quarterly report on Form 10-Q for the quarter ended August 31, 2002.

For detailed information regarding the full effects of the restatement of Liberate's financial statements and for a discussion of subsequent events, please see our amended Annual Report on Form 10-K/A for the fiscal year ended May 31, 2002 the quarterly reports on Form 10-Q for the quarters ended August 31, 2002, November 30, 2002, and February 28, 2003 and our Annual Report on Form 10-K for the fiscal year ended May 31, 2003, which are being filed concurrently with this Amendment No. 1.

Additionally, in June 2001, we granted three officers options to purchase 810,000 shares of common stock with an exercise price of $8.47 per share, which was the common stock closing price on the grant date. In December 2001, we cancelled a like number of options for these officers. The cancelled options had originally been granted at the commencement of each officer's employment, and one option grant had an exercise price of $17.88 per share and the other two option grants had exercise prices of $32.44 per share. As a result of the cancellations, we are treating the June 2001 stock options as repriced grants and we are using variable stock option accounting. Based on the November 30, 2001 common stock price of $9.15, we recorded $207,000 in stock-based compensation expense and recorded deferred stock-based compensation of $344,000 as of November&