TREND MICRO INC
Form 20-F
June 01, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 20-F

(Mark One)

¨ **Registration statement pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934**

or

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 333-10486

TREND MICRO KABUSHIKI KAISHA

(Exact Name of Registrant as Specified in Its Charter)

TREND MICRO INCORPORATED

(Translation of Registrant s Name Into English)

JAPAN

(Jurisdiction of Incorporation or Organization)

Shinjuku MAYNDS Tower, 1-1, Yoyogi 2-chome, Shibuya-ku, Tokyo

151-0053, Japan

(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
None	None

Securities registered or to be registered pursuant to Section 12(g) of the Act:

(1) Common Stock*

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2003, 130,661,453 shares of common stock were outstanding, including 864,000 American Depositary Shares represented by 864,000 shares of common stock.

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 which financial statement item the registrant has elected to follow.

Item 17 ¨ Item 18 x

All information contained in this report is as of December 31, 2003 or for the year ended December 31, 2003 unless the context otherwise indicates. In tables appearing in this annual report, figures may not add up to totals due to rounding.

* Not for trading, but only in connection with the registration of American Depositary Shares, each of which represents one share of Common Stock.

Cautionary Statement Regarding Forward-Looking Statements

This annual report on Form 20-F contains forward-looking statements within the meaning of the Section 21E of the Securities Exchange Act of 1934. To the extent that statements in this annual report do not relate strictly to historical or current facts, they may constitute forward-looking statements. These forward-looking statements are based upon management s current assumptions and beliefs in light of the information currently available to it, but involve known and unknown risks and uncertainties. Our actual actions or results may differ materially from those discussed in the forward-looking statements. We undertake no obligation to publicly update any forward-looking statement after the date of this annual report, but investors are advised to consult any further disclosures by us in our subsequent filings pursuant to the Securities Exchange Act of 1934.

Important risks and factors that could cause our actual results to differ materially from our expectations are generally set forth in Item 3.D of this annual report and include, without limitation:

- difficulties in addressing new virus and other computer security problems;
- timing of new product introductions and lack of market acceptance for our new products;
- the level of continuing demand for, and timing of sales of, our existing products;
- rapid technological change within the anti-virus software industry;
- changes in customer needs for anti-virus software;
- existing products and new product introductions by our competitors and the pricing of these products;
- declining prices for our products and services;
- the effect of future acquisitions on our financial condition and results of operations;
- the effect of adverse economic trends on our principal markets;
- the effect of foreign exchange fluctuations on our results of operations;
- an increase in the incidence of product returns;
- the potential lack of attractive investment targets;
- difficulties in successfully executing our investment strategy; and

other risks discussed under Risk Factors and elsewhere in this annual report.

As used in this annual report, unless otherwise specified, references to Trend Micro are to Trend Micro Incorporated. Also, as used in this annual report, references to we , our and us are to Trend Micro Incorporated and, except as the context otherwise requires, its consolidated subsidiaries.

Also, as used in this annual report:

dollar or $ means the lawful currency of the United States of America, and yen or (Yen) means the lawful currency of Japan.

U.S. GAAP means generally accepted accounting principles in the United States.

ADS means an America Depositary Share, each representing 1 share of our common stock, and ADR means an American Depositary Receipt evidencing ADSs.

fiscal 2003 and fiscal year 2003 refer to our fiscal year ended December 31, 2003, and other fiscal years are referred to in a corresponding manner.

In tables appearing in this annual report, figures may not add up to totals due to rounding.

PART I

Item 1. Identity of Directors, Senior Management and Advisers.

Not applicable

Item 2. Offer Statistics and Expected Timetable.

Not applicable

Item 3. Key Information.

A. Selected Financial Data.

You should read the following selected consolidated financial information together with the financial statements and notes to the statements which begin on page F-2 and are in response to Item 8 and Item 18. You should also read the Operating and Financial Review and Prospects included as Item 5.

The consolidated income statement information for the fiscal years ended December 31, 2001, 2002 and 2003, and the consolidated balance sheet information as of December 31, 2002 and 2003, are derived from and should be read together with our consolidated financial statements prepared in accordance with U.S. GAAP, which have been audited by PricewaterhouseCoopers, independent auditors, and are included elsewhere in this annual report.

The consolidated income statement information for the fiscal years ended December 31, 1999 and 2000, and the consolidated balance sheet information as of December 31, 1999, 2000 and 2001 are derived from our consolidated financial statements prepared in accordance with U.S. GAAP, which have been audited by PricewaterhouseCoopers, independent auditors, but are not included in this annual report.

	Year Ended December 31,					
	1999	2000	2001	2002	2003	2003
	(in millions of yen and thousands of dollars, except per share data)					
Sales	(Yen)13,633	(Yen)20,070	(Yen)31,326	(Yen)42,980	(Yen)48,088	$ 449,424
Cost of sales	481	1,474	1,899	2,354	3,168	29,612
Gross profit	13,152	18,596	29,427	40,626	44,920	419,812
Operating expenses:(1)						
Selling	3,454	5,445	10,001	15,052	15,360	143,556

Research and development and maintenance	994	2,044	2,755	3,506	3,919	36,627
Customer Support			2,449	3,858	4,831	45,146
General and administrative	4,772	5,304	4,453	4,344	5,656	52,861
Goodwill amortization		276				
Goodwill write-off			2,253			
Total operating expenses	9,220	13,069	21,911	26,760	29,766	278,190
Operating income	3,932	5,527	7,516	13,866	15,154	141,622
Other income (expense), net	67	1,365	241	(768)	175	1,640
Income before income taxes, minority interest and equity in earnings (losses) of affiliated companies	3,999	6,892	7,757	13,098	15,329	143,262
Income taxes	1,849	3,123	3,241	5,395	6,103	57,034
Income before minority interest and equity in earnings (losses) of affiliated companies	2,150	3,769	4,516	7,703	9,226	86,228
Minority interest in income of a consolidated subsidiary		7				
Income from consolidated companies	2,150	3,762	4,516	7,703	9,226	86,228
Equity in earnings (losses) of affiliated companies	(3)	(87)	(130)	11	24	221
Net income	(Yen)2,147	(Yen)3,675	(Yen)4,386	(Yen)7,714	(Yen)9,250	$ 86,449
Net income per share (basic)(2)	(Yen)16.90	(Yen)28.18	(Yen)33.33	(Yen)58.39	(Yen)70.11	$ 0.66

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	Year Ended December 31,					
	1999	2000	2001	2002	2003	2003
	(in millions of yen and thousands of dollars, except per share data)					
Net income per share (diluted)(2)	(Yen) 16.42	(Yen) 27.53	(Yen) 33.02	(Yen) 58.22	(Yen) 69.95	$ 0.65
Cash dividends per share(2)	(Yen) 1.67	(Yen)	(Yen)	(Yen)	(Yen)	$
Weighted average common shares outstanding (basic)(2)	127,100,328	130,388,962	131,594,913	132,111,467	131,940,179	
Weighted average common shares outstanding (diluted)(2)	130,752,652	133,454,940	132,832,159	132,494,201	132,235,128	

(1) Effective from the year ended December 31, 2003, we started to report customer support expenses, previously included in general and administrative expenses, as a separate line item under Operating expenses and reclassified certain operating expenses such as overhead costs from general and administrative expenses to selling expenses. We have retroactively made corresponding changes in our income statements for the years ended December 31, 2001 and 2002. We have not made corresponding changes in our income statements for the years ended December 31, 1999 and 2000, because we do not have data from those years that form the basis for reclassifying the operating expense line items in the manner described above.

(2) We effected a one-to-two stock split on May18, 2001. The share and per share amounts for each of the three years ended December 31, 2001 have been restated to reflect that stock split.

	Year Ended December 31,					
	1999	2000	2001	2002	2003	2003
	(in millions of yen and thousands of dollars, except per share data)					
Consolidated Balance Sheet Information						
Cash and cash equivalents	(Yen) 15,649	(Yen) 24,436	(Yen) 40,783	(Yen) 47,830	(Yen) 46,719	$ 436,626
Total assets	28,781	44,574	64,729	73,838	81,271	759,543
Current portion of long-term debt		57	3,000	5,000	6,500	60,748
Long-term debt	6,000	9,800	11,500	6,500		
Total liabilities	11,471	20,230	33,963	36,694	37,319	348,778
Common stock	5,415	6,183	6,834	7,257	7,396	69,123
Shareholders equity	(Yen) 17,310	(Yen) 24,344	(Yen) 30,766	(Yen) 37,144	(Yen) 43,952	$ 410,765

Exchange Rates.

In this annual report, we have translated Japanese yen amounts into U.S. dollars solely for the convenience of readers. Unless otherwise indicated, the rate we used for the translation was (Yen) 107. 00 per $1, which was the approximate rate on December 31, 2003. The following table shows the noon buying rates for Japanese yen expressed in Japanese yen per $1. On May 28, 2004 the noon buying rate announced by the Federal Reserve Bank of New York was (Yen) 110.18 per $1.

Year ended/ending December 31,	High	Low	Average(1)	Period-end
1999	124.45	101.53	112.79	102.16

2000	114.62	101.70	108.37	114.35
2001	131.47	114.26	122.18	131.04
2002	134.77	115.71	124.81	118.75
2003	121.42	106.93	115.99	107.13
2004 (through May 28, 2004)	114.30	103.70	107.97	110.18
Calendar Year 2003				
December	109.61	106.93	107.74	107.13
Calendar Year 2004				
January	107.17	105.52	106.27	105.84
February	109.59	105.36	106.71	109.26
March	112.12	104.18	108.52	104.18
April	110.37	103.70	107.66	110.37
May (until May 28, 2004)	114.30	108.50	112.20	110.18

(1) For annual averages, calculated based on the average of the exchange rates on the last day of each month during the period. For monthly averages, calculated based on the average of daily closing exchange rates.

B. Capitalization and Indebtedness.

Not applicable

C. Reasons for the Offer and Use of Proceeds.

Not applicable

D. Risk Factors.

The occurrence of any of the following risks could hurt our business, financial condition or results of operations. In such case, the trading price of our shares and the ADSs could decline and you could lose all or part of your investment. Other risks and uncertainties not now known to us or that we think are immaterial may also impair our business.

MAJOR SOFTWARE AND HARDWARE VENDORS MAY INCORPORATE ANTI-VIRUS PROTECTION IN THEIR PRODUCT OFFERINGS, WHICH COULD RENDER OUR PRODUCTS OBSOLETE OR UNMARKETABLE.

Major vendors of operating system software and other software such as firewall or e-mail software or computer hardware may decide to enhance or bundle their products with their other products to include anti-virus functions. These companies may offer anti-virus protection as a standard feature in their products, at minimal or no additional cost to customers. This could render our products obsolete or unmarketable, particularly if anti-virus products offered by these vendors were comparable or superior to our products. In addition, even if these vendors anti-virus products offered fewer functions than our products, or were less effective in detecting and cleaning virus-infected files, customers could still choose them over our products due to lower cost or for any other reasons.

In June 2003, Microsoft Corp., a major operating system vendor, announced that it acquired certain valuable intellectual property and technology assets from GeCAD Software Srl., an antivirus software vendor in Romania. At this time, we do not know the intentions of Microsoft, but if antivirus functions were to be included in its operating system products, this could have a material adverse effect on our business, financial condition and results of operations.

BECAUSE WE GENERATE SUBSTANTIALLY ALL OF OUR REVENUE FROM A SINGLE PRODUCT LINE, WE ARE VULNERABLE TO DECREASED DEMAND FOR SUCH PRODUCTS.

Unlike software companies with diversified product lines, we derive substantially all of our net sales from licensing and selling anti-virus software products. Although we have begun to offer more comprehensive network and internet security and management software and services, we expect anti-virus products to continue to account for the largest portion of our net sales for the foreseeable future. If the demand for, or the prices of, anti-virus products drop as a result of competition, technological change or other factors such as lower growth or a contraction in the worldwide anti-virus software market, this could have a material adverse effect on our business, financial condition and results of operations.

DETERIORATION IN OUR RELATIONSHIP WITH SOFTBANK BB CORP. COULD RESULT IN A DECREASE IN SALES OF OUR PRODUCTS.

We depend on our relationship with SOFTBANK BB (formerly known as SOFTBANK COMMERCE CORP.), which is our largest customer and has played an instrumental role in the development of our business in Japan. SOFTBANK BB also has close relationships with many distributors and systems integrators through which we sell our anti-virus software to corporate end users in Japan. An adverse change in our relationship with SOFTBANK BB would result in decreased sales to SOFTBANK BB and could disrupt our relationship with many distributors of our products. This could make it difficult for us to market our products in Japan. Sales to SOFTBANK BB totaled approximately (Yen)7.4 billion, or 23.5%, of our net sales in fiscal 2001, approximately (Yen)10.1 billion, or 23.6%, of our net sales in fiscal 2002 and approximately (Yen)9.2 billion ($86.0 million), or 19.1%, of our net sales in fiscal 2003. Because of our dependence on SOFTBANK BB, the price of shares and ADSs could fall as a result of adverse events affecting SOFTBANK BB, even if the events do not relate directly to us.

OUR PRODUCTS MAY BECOME OBSOLETE BECAUSE RAPID TECHNOLOGICAL CHANGE REGULARLY OCCURS IN THE ANTI-VIRUS SOFTWARE MARKET.

The anti-virus software market is characterized by:

- rapid technological change;
- the proliferation of new and changing computer viruses;
- frequent product introductions and updates; and
- changing customer needs.

These characteristics of our market create significant risks and uncertainties for our business success. For example, our competitors might introduce anti-virus products that are technologically superior to our products. Additionally, new software operating system, network system or anti-virus software industry standards could emerge. Emerging trends in these systems and standards currently include applications distributed over the Internet and the use of a Web browser to access client-server systems. Our existing products might be incompatible with some or all of such standards. Our business, financial condition and results of operations could materially suffer unless we are able to respond quickly and effectively to these developments.

OUR HARDWARE-BASED PRODUCTS FACE MANUFACTURING AND INVENTORY RISKS.

We rely on a small number of third parties to manufacture some of our hardware-based products, such as Trend Micro Network VirusWall described in Item 4.B. We expect our reliance on third-party manufacturers to become more important as the number of our hardware-based products increases. Reliance on third-party manufacturers involves a number of risks, including a lack of control over the manufacturing process and the potential absence or unavailability of adequate capacity. If any of our third-party manufacturers cannot or will not manufacture our products in required volumes, on a cost-effective basis, in a timely manner, or at all, we will have to secure additional manufacturing capacity. The unexpected loss of any of our manufacturers could disrupt our business. Furthermore, our hardware-based products contain critical components supplied by a single or a limited number of third parties. Any significant shortage of components or the failure of the third-party supplier to maintain or enhance these products could lead to cancellation of customer orders or delays in the placement of orders and adversely affect our financial condition and results of operation.

WE MAY NOT GENERATE EXPECTED RESULTS IN STRATEGIC ALLIANCES

Because we are focusing our business on the field of antivirus and do not have other security products like Firewall, we actively pursue positive about strategic alliances with other companies to provide new products and services derived from the alliances. In fiscal 2003, we began to provide spam mail prevention solution with Postini and integrated security appliance with Netscreen. To launce and provide such products and services, we may invest substantial cash and other resources in product developments, marketing promotions and support and maintenance activities. But we may not earn revenue successfully from alliances despite our efforts, and such alliance may be terminated or dissolved by various causes before generating revenue.

WE MAY NOT BE ABLE TO INCREASE OUR MARKET SHARE IN THE U.S. AND EUROPEAN MARKETS BECAUSE OUR COMPETITORS ARE MORE ESTABLISHED THAN WE ARE IN THESE MARKETS.

We believe that our share of the anti-virus software market in the U.S. and Europe is significantly small relative to the market shares of our principal competitors, despite the growth of our sales in these markets in fiscal 2002 and 2003. Because our competitors are already well-established in these key markets and have greater financial and other resources and market recognition, we may not be able to compete effectively for market share. If this happens, we may not be able to increase sales or our market share in these markets, which could materially hurt the prospects for growth in our business.

Some of our major competitors have the following important advantages over us in the U.S. and European markets:

- greater name recognition;
- more diversified product lines;
- larger customer bases; and
- significantly greater financial, technical, marketing and other resources.

As a result, as compared to us, our competitors may be able to:

- better withstand downturns in the anti-virus software market and in the computer software market in general;
- adapt more quickly to new or emerging technologies or changes in customer requirements; or
- more effectively and profitably market, sell and support their products.

WE MAY SUFFER A LOSS OF SALES AND MARKET SHARE IN OUR CORE JAPANESE MARKET IF OUR COMPETITORS ACHIEVE SUCCESS IN JAPAN.

Our major competitors, Network Associates and Symantec Corporation, are active in the Japanese anti-virus software market and have allocated significant resources to achieve success in the Japanese anti-virus software market. Although these competitors currently have smaller shares of the Japanese market than us, each has significantly greater financial, marketing and other resources than we do. Additionally, competition in our core Japanese market could intensify in the future if other competitors emerge. As a result of our competitors efforts, we may not be able to maintain our current leading market position in Japan in the future. Also, in order to respond effectively to increased competition, we may be required to devote more of our product development, marketing and other resources to the Japanese market, which could limit our ability to grow in other markets. A material loss of sales and market share in Japan as a result of our competitors success could have a material adverse effect on our business, financial condition and results of operations.

BECAUSE WE MAY ACQUIRE COMPANIES TO GROW OUR BUSINESS, FUTURE ACQUISITIONS MAY REDUCE OUR EARNINGS AND RESULT IN INCREASED COSTS IN OUR BUSINESS OPERATIONS.

In a rapidly changing industry, we occasionally review acquisition opportunities. Accordingly, we may seek to expand our business through acquisitions. Unlike some of our major competitors, we have limited experience in acquiring existing businesses. Future acquisitions could result in numerous risks and uncertainties, including:

- our inability to retain customers, suppliers and other important business relationships of an acquired business;
- difficulties in integrating an acquired company into Trend Micro, including the acquired company s operations, personnel, products and information systems;
- diversion of our management s attention from other business concerns; and
- adverse effects on our results of operations from acquisition-related charges, impairment of goodwill and purchased technology and possible recognition of impairment charge.

If we make such an acquisition using stock, our current shareholders ownership interests will be diluted. Any of these factors could materially hurt our business, financial condition and results of operations.