ART TECHNOLOGY GROUP INC
Form 10-Q
August 14, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2001

OR

o **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 000 26679

ART TECHNOLOGY GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**04 3141918** (I.R.S. Employer Identification Number)
25 First Street, Cambridge, Massachusetts (Address of principal executive offices)	**02141** (Zip Code)

(617) 386-1000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 ý No o

As of August 8, 2001 there were 68,677,121 shares of the Registrant's common stock outstanding.

ART TECHNOLOGY GROUP, INC.
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PART I. FINANCIAL INFORMATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ART TECHNOLOGY GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands, except share and per share data)

	(UNAUDITED) **June 30, 2001**	**December 31, 2000**
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 43,179	$ 53,255
Marketable securities	51,672	73,218
Accounts receivable, net of reserves of approximately $2,694 and $2,655 at June 30, 2001 and December 31, 2000, respectively	40,042	52,440
Unbilled services	242	1,273
Prepaid expenses and other current assets	7,058	4,222
Deferred tax assets	3,556	3,556
Total current assets	145,749	187,964
Property and Equipment, Net	27,147	23,492
Long-Term Marketable Securities		17,734
Other Assets	12,061	13,246
Deferred Tax Assets	45,388	17,079
	$ 230,345	$ 259,515
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		

Current maturities of long-term obligations	$	2,000	$	2,000
Accounts payable		5,714		11,375
Accrued expenses		24,867		29,402
Accrued restructuring current (Note 10)		17,981		--
Deferred revenues		19,655		22,765
Total current liabilities		70,217		65,542
Accrued Restructuring Long-Term (Note 10)		18,960		--
Long-Term Obligations, Less Current Maturities		1,000		2,000
Total liabilities	$	90,177	$	67,542
Commitments and Contingencies (Note 7)				
Stockholders' Equity:				
Preferred stock, $.01 par value				
Authorized 10,000,000 Issued and outstanding no shares				
Common stock, $.01 par value				
Authorized 500,000,000				
Issued and outstanding 68,635,583 shares and 67,894,357 shares at June 30, 2001 and December 31, 2000, respectively		686		679
Additional paid-in capital		211,302		209,338
Deferred compensation		(2,499)		(3,670)
Accumulated deficit		(69,166)		(14,374)
Accumulated other comprehensive loss		(155)		--
Total stockholders' equity		140,168		191,973
	$	230,345	$	259,515

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

ART TECHNOLOGY GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(UNAUDITED)

	Three Months Ended June 30,				Six Months Ended June 30,			
	2001		2000		2001		2000	
REVENUES:								
Product license	$	19,083	$	23,811	$	44,564	$	40,058
Services		15,985		8,818		33,350		14,143
Total revenues		35,068		32,629		77,914		54,201

COST OF REVENUES:				
Product license	1,100	865	2,147	1,573
Services	12,012	6,897	27,520	11,889
Total cost of revenues	13,112	7,762	29,667	13,462
Gross profit	21,956	24,867	48,247	40,739
OPERATING EXPENSES:				
Research and development	8,146	4,095	17,179	7,690
Sales and marketing	26,725	14,339	56,835	25,391
General and administrative	5,783	5,014	15,060	8,689
Stock-based compensation	323	304	704	608
Restructuring	44,235		44,235	
Total operating expenses	85,212	23,752	134,013	42,378
INCOME (LOSS) FROM OPERATIONS	(63,256)	1,115	(85,766)	(1,639)
INTEREST INCOME, NET	1,339	2,254	3,182	4,401
OTHER INCOME	329		170	
Net income (loss) before provision for (benefit from) income taxes	(61,588)	3,369	(82,414)	2,762
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(19,708)	500	(27,622)	500
Net income (loss)	$ (41,880)	$ 2,869	$ (54,792)	$ 2,262
Net income (loss) per share:				
Basic	$ (0.61)	$ 0.04	$ (0.80)	$ 0.03
Diluted	$ (0.61)	$ 0.04	$ (0.80)	$ 0.03
Weighted average common shares outstanding:				
Basic	68,595	66,655	68,387	66,339
Diluted	68,595	72,855	68,387	72,872

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

ART TECHNOLOGY GROUP, INC.
CONSOLIDATED CONDENSED STATEMENT OF CASH FLOWS
(In thousands)
(UNAUDITED)

	Six Months Ended	
	June 30, 2001	**June 30, 2000**

CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income (loss)	$	(54,792)	$	2,262
Adjustments to reconcile net loss to net cash used in operating activities				
Stock-based compensation		704		608
Depreciation and amortization		6,069		1,121
Benefit from income taxes		(27,622)		---
Loss on disposal of fixed assets		4,613		---
Changes in current assets and liabilities				
Accounts receivable, net		12,398		(10,969)
Unbilled services		1,030		(1,284)
Prepaid expenses and other current assets		(2,836)		(1,368)
Accounts payable		(5,660)		(5,329)
Accrued expenses		(5,195)		8,111
Accrued restructuring current		17,981		--
Accrued restructuring long term		18,960		--
Deferred revenues		(3,110)		4,079
Net cash used in operating activities		(37,460)		(2,769)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Proceeds from (purchases of) marketable securities, net		39,280		(45,702)
Purchases of property and equipment		(12,609)		(4,863)
Cash paid to acquire Petronio Technology Group, Inc.		--		(600)
(Increase) decrease in other assets		(738)		905
Net cash provided by (used in) investing activities		25,933		(50,260)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from exercise of stock options		1,047		1,678
Proceeds from employee stock purchase plan		1,391		759
Payments on long-term obligations		(1,000)		(1,500)
Net cash provided by financing activities		1,438		937
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		13		---
NET DECREASE IN CASH AND CASH EQUIVALENTS		(10,076)		(52,092)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		53,255		124,711
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	43,179	$	72,619
SUPPLEMENTAL DISCLOSURE OR CASH FLOW INFORMATION:				
Cash paid during the period for interest	$	131	$	
Cash paid during the period for income taxes	$	168	$	

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

ART TECHNOLOGY GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

1. OPERATIONS AND BASIS OF PRESENTATION

Art Technology Group, Inc. (ATG or the Company) is a Delaware corporation which was incorporated on December 31, 1991. The Company offers an integrated suite of internet customer relationship management and electronic commerce software applications, as well as related application development, integration and support services.

The accompanying consolidated financial statements of the Company have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all of the information and disclosures required by generally accepted accounting principles. While the Company believes that the disclosures presented are adequate to make information not misleading, these financial statements should be read in conjunction with the audited financial statements and related notes included in the Company's 2000 Annual Report and Form 10-K. In the opinion of management, the accompanying consolidated condensed financial statements and notes herein are unaudited but, contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. The operating results for the three and six months ended June 30, 2001 are not necessarily indicative of the results to be expected for the full year ending December 31, 2001.

The accompanying consolidated condensed financial statements include the accounts of ATG and its wholly owned subsidiaries. All significant intercompany balances have been eliminated in consolidation.

2. NET INCOME (LOSS) PER SHARE INFORMATION

Net income (loss) per share is computed under Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings Per Share*. Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding, including potential common shares from the exercise of stock options and warrants using the treasury stock method, if dilutive. The following table sets forth basic and diluted income (loss) per share computational data for the periods presented (in thousands, except per share amounts):

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	June 30, 2001	June 30, 2000	June 30, 2001	June 30, 2000
Net income (loss)	$ (41,880)	$ 2,869	$ (54,792)	$ 2,262
Weighted average common shares outstanding used in computing basic net income (loss) per share	68,595	66,655	68,387	66,339
Weighted average common equivalent shares outstanding:				
employee stock options	---	6,200	---	6,533
Total weighted average common and common equivalent shares outstanding used in computing diluted net income (loss) per share	68,595	72,855	68,387	72,872
Basic net income (loss) per share	$ (0.61)	$ 0.04	$ (0.80)	$ 0.03
Diluted net income (loss) per share	$ (0.61)	$ 0.04	$ (0.80)	$ 0.03

Options and warrants to purchase a total of 13,359,150 shares of common stock have been excluded from the computation of diluted weighted average shares outstanding for the three and six months ended June 30, 2001, and have been excluded from the calculation of diluted net loss per share as the effect of their inclusion would have been anti-dilutive.

Options to purchase a total of 3,619,977 and 3,332,576 weighted shares of common stock outstanding for the three and six months ended June 30, 2000, respectively, were excluded from the calculation of diluted net income per share because the exercise prices of those options exceeded the average market price of common stock during the periods.

3. REVENUE RECOGNITION

ATG recognizes product license revenues from licensing the rights to use its software to end-users. ATG also generates service revenues from integrating its software with its customers' operating environments, the sale of maintenance services and the sale of certain other consulting and development services. ATG generally has separate agreements with its customers, which govern the terms and conditions of its software licenses, consulting and support and maintenance services. These separate agreements, along with ATG's price list and business practices, provide the basis for establishing vendor-specific objective evidence of fair value. This allows ATG to appropriately allocate fair value among the multiple elements in an arrangement.

ATG recognizes revenue in accordance with Statement of Position (SOP) No. 97-2*, Software Revenue Recognition* and SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions.* Revenues from software product license agreements are recognized upon execution of a license agreement and delivery of the software, provided that the fee is fixed or determinable and deemed collectible by management. If conditions for acceptance are required subsequent to delivery, revenues are recognized upon customer acceptance if such acceptance is not deemed to be perfunctory. In multiple element arrangements, ATG uses the residual value method in accordance with SOP 97-2 and SOP 98-9. Revenues from software maintenance agreements are recognized ratably over the term of the maintenance period, which is typically one year. ATG enters into reseller arrangements that typically provide for sublicense fees payable to ATG based upon a percentage of ATG's list price. Revenues are recognized under reseller agreements as earned, which is generally ratably over the life of the reseller agreement, for guaranteed minimum royalties or based upon actual sales by the resellers. ATG does not grant its resellers the right of return or price protection. Revenues from professional service arrangements are recognized on either a time-and-materials or percentage-of-completion basis as the services are performed, provided that amounts due from customers are fixed or determinable and deemed collectible by management. Amounts collected or billed prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Unbilled services represent service revenues that have been earned by ATG in advance of billings.

4. FOREIGN CURRENCY TRANSLATION

The financial statements of the Company s wholly owned foreign subsidiaries are translated in accordance with SFAS No. 52, Foreign Currency Translation. Assets and liabilities of the Company s wholly owned foreign subsidiaries are translated to the U.S. dollar from their local functional currencies at the exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average exchange rates prevailing during the month. Resulting translation adjustments are reflected as a separate component of stockholders equity. Foreign currency transaction gains and losses are included in results of operations.

5. CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company accounts for investments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. In accordance with SFAS No. 115, investments for which the Company has the positive intent and ability to hold to maturity, consisting of cash equivalents and marketable securities, are reported at amortized cost, which approximates fair market value. Cash equivalents are highly liquid investments with original maturities of ninety days or less. Marketable securities are investment-grade securities with original maturities of greater than ninety days. The average maturity of the Company's marketable securities is approximately 8.0 months and 11.4 months at June 30, 2001 and December 31, 2000, respectively. At June 30, 2001 and December 31, 2000, the difference between the amortized cost and market value of ATG s marketable securities was approximately $442,000 and $181,000, respectively.

		June 30, 2001		December 31, 2000
		(in thousands)		
Cash and cash equivalents				
Cash	$	5,487	$	4,880
Money market accounts		37,692		35,314
Corporate securities		---		13,061
Total cash and cash equivalents	$	43,179	$	53,255
Marketable securities				
Corporate securities	$	51,672	$	90,952

Total marketable securities	$	51,672	$	90,952

6. STOCK-BASED COMPENSATION

In connection with certain stock option grants during the year ended December 31, 1998 and 1999, the Company recorded deferred compensation of approximately $4.9 million. Additionally, in July 2000, ATG recorded deferred compensation of $2.0 million related to unvested stock options acquired in connection with the acquisition of The Toronto Technology Group Inc. These amounts represent the aggregate difference between the exercise price and the fair market value of common stock as determined for accounting purposes. The deferred compensation is being recognized as an expense over the vesting period of the underlying stock options. The Company recorded compensation expense of $323,000 and $304,000 for the three months ended June 30, 2001 and 2000, respectively, and $704,000 and $608,000 for the six months ended June 30, 2001 and 2000, respectively, related to these options.

7. LONG-TERM OBLIGATIONS

In connection with a settlement of the patent infringement claim by BroadVision, Inc. ("BroadVision"), ATG acquired a perpetual, paid-up license for BroadVision's patented technology. ATG paid $11,000,000 during the year December 31, 2000 and $1,000,000 during the six months ended June 30, 2001. ATG will pay the remaining $3,000,000 with quarterly installments of $500,000 through the end of 2002. These payments are included in the accompanying consolidated balance sheet, as follows: $2,000,000 in current maturities of long-term obligations and $1,000,000 in long-term obligations, less current maturities.

ATG has a revolving line of credit with a bank, under which ATG may borrow up to $12,500,000. Borrowings bear interest at the bank s prime rate (6.75% at June 30, 2001). The revolving line of credit is collateralized by substantially all assets of ATG. As of June 30, 2001 there was no availability under the line of credit. Effective July 23, 2001, ATG modified the terms of the line of credit with the bank to eliminate all of the financial covenants. As part of this modification, ATG agreed to provide 100% cash collateral for its outstanding letters of credit, which totalled 12,768,000 as of June 30, 2001.

8. COMPREHENSIVE INCOME (LOSS)

SFAS No. 130, *Reporting Comprehensive Income,* requires that a full set of general purpose financial statements be expanded to include the reporting of "comprehensive income (loss)". Comprehensive income (loss) is comprised of two components, net income (loss) and other comprehensive income (loss). The following are the components of ATG s comprehensive income (loss) (in thousands):

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	June 30, 2001	June 30, 2000	June 30, 2001	June 30, 2000
Net income (loss)	$ (41,880)	$ 2,869	$ (54,792)	$ 2,262
Foreign currency translation loss	(237)	-	(155)	-
Comprehensive income (loss)	$ (42,117)	$ 2,869	$ (54,947)	$ 2,262

The accumulated other comprehensive loss at June 30, 2001 of $155,000 consisted entirely of the cumulative foreign currency translation losses.

9. DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE

SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information,* establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions how to allocate resources and assess performance. The Company s chief operating decision-makers, as defined under SFAS No. 131, is its executive management team. To date, the Company has viewed its operations and manages its business as principally one segment with two product offerings: software licenses and services. The Company evaluates these product offerings based on their respective gross margins. As a result, the financial information disclosed herein represents all of the material financial information related to the Company s principal operating segment.

Revenues from sources outside of the United States were approximately $11,999,000 and $7,067,000 for the three months ended June 30, 2001 and 2000, respectively, and $26,320,000 and $9,474,000 for the six months ended June 30, 2001 and 2000, respectively. ATG s revenue from international sources were primarily generated from customers located in Europe and Canada. All of the ATG s product sales for the three and six months ended June 30, 2001 and 2000 were delivered from its headquarters located in the United States.

The following table represents the percentage of total revenues by geographical location:

	Three months ended June 30,		Six months ended June 30,	
	2001	2000	2001	2000
United States	66%	78%	66%	83%
United Kingdom (UK)	8	10	13	7
Europe, Middle East and Africa (excluding UK)	18	9	15	8
Canada	5	2	3	2
Other	3	1	3	-
	100%	100%	100%	100%

10. RESTRUCTURING

As a result of a global slowdown in IT spending, ATG recorded a $44.2 million restructuring charge for the quarter ended June 30, 2001 for restructuring costs primarily related to facilities and employee severance. Other components of the restructuring charge include cancellation of marketing commitments, outplacement services, and other workforce related costs. The following are the significant components of the restructuring charge (in thousands):

Facilities related costs	$	37,563
Employee severance, benefits and related costs		4,653
Marketing costs		851
Legal and accounting costs		254
Other		914
Total	$	44,235

The employee severance cost component of the restructuring charge was related to reductions in personnel. As part of the restructuring, ATG terminated 32% or approximately 380 personnel. Approximately 51% of the employees were from sales and marketing, 26% from services, 16% from general and administrative, and 7% from research and development.

The facilities related cost component consisted of idle lease space and termination payments for offices worldwide, which are no longer required as a result of the reduction in personnel. In determining the facilities related costs, ATG has estimated the vacancy period and sub-let income.

At June 30, 2001, ATG had an accrued restructuring liability of $36.9 million, of which $19.0 million was long-term, which consisted of the following:

Facilities related costs	$	32,936
Employee severance, benefits and related costs		3,501
Legal and accounting costs		200
Other		304
Total	$	36,941

11. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement on Financial Accounting Standards (SFAS) No. 141, *Business Combinations.* SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. The adoption of SFAS No. 141 is not expected to have a material impact on the Company's consolidated financial statements.

In July 2001, the FASB also issued SFAS No. 142, *Goodwill and Other Intangible Assets.* Under SFAS No. 142, goodwill is no longer subject to amortization over its estimated useful life. Rather, goodwill is subject to at least an annual assessment for impairment by applying a fair-value-based test. Also under SFAS No. 142, intangible assets acquired in conjunction with a business combination should be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer's intent to do so. Intangible assets will continue to be amortized over their respective useful lives under SFAS No. 142.

The Company must adopt SFAS No. 141 and SFAS No. 142 on January 1, 2002. Upon adoption, goodwill will no longer be amortized. Rather, the Company must reassess impairment of goodwill and record any impairment loss during 2002. The Company is currently assessing the impact of SFAS No. 142 related to the impairment of goodwill.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The statements contained in this Report on Form 10-Q that are not purely historical statements are forward-looking statements within the meaning of Section 21E of the Securities and Exchange Act of 1934, including statements regarding our expectations, beliefs, hopes, intentions or strategies regarding the future. These forward-looking statements involve risks and uncertainties. Actual results may differ materially from those indicated in such forward-looking statements.

Overview

We were founded in December 1991. From 1991 through 1995, we devoted our efforts principally to building, marketing and selling our professional services capabilities and to research and development activities related to our software products. Beginning in 1996, we began to focus on selling our software products. To date, we have enhanced and released several versions of our Dynamo product suite of applications. We market and sell our products worldwide through our direct sales force, systems integrators, technology partners and original equipment manufacturers.

We derive our revenues from the sale of software product licenses and related services. Product license revenues are derived from the sale of perpetual software licenses of our Dynamo products. Our software licenses are priced based on either the size of the customer implementation or site license terms. Services revenues are derived from fees for professional services, training and software maintenance and support. Professional services include custom application development and project and technical consulting. We bill professional service fees either on a time and materials basis or, in some cases, on a fixed-price schedule defined specifically in our contracts. Software maintenance and support arrangements are priced based on the level of services provided. Generally, customers are entitled to receive software updates, maintenance releases and technical support for an annual maintenance fee of 8% to 25% of the list price of the licensed product. Customers that purchase maintenance and support generally receive all product updates and upgrades of software modules purchased as well as Web-based and telephone technical support. Training is billed as services are provided.

We recognize revenue in accordance with Statement of Position (SOP) No. 97-2*, Software Revenue Recognition* and SOP 98-9*, Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions.* Revenues from software product license agreements are recognized upon execution of a license agreement and delivery of the software, provided that the fee is fixed or determinable and deemed collectible by management. If conditions for acceptance are required subsequent to delivery, revenues are recognized upon customer acceptance if such acceptance is not deemed to be perfunctory. In multiple element arrangements, we use the residual value method in accordance with SOP 97-2 and SOP 98-9. Revenues from software maintenance agreements are recognized ratably over the term of the maintenance period, which is typically one year. We enter into reseller arrangements that typically provide for sublicense fees payable to us based upon a percentage of our list price. Revenues are recognized under reseller agreements as earned which is generally ratably over the life of the reseller agreement for guaranteed minimum royalties or based upon actual sales by the resellers. We do not grant our resellers the right of return or price protection. Revenues from professional service arrangements are recognized on either a time and materials or percentage-of-completion basis as the services are performed, provided that amounts due from customers are fixed or determinable and deemed collectible by management. Amounts collected prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Unbilled services represent service revenues that have been earned by us in advance of billings.

We have invested financial and managerial resources to expand our sales and marketing operations in international markets. Revenues from customers outside the United States accounted for 22% and 34% of our total revenues for the three months ended June 30, 2000 and 2001, respectively, and 17% and 34% for the six months ended June 30, 2000 and 2001, respectively. We have not entered into contracts denominated in foreign currencies to date, but may in the future. We currently do not have hedging or similar arrangements to protect us against foreign currency fluctuations. We, therefore, increasingly may become subject to currency fluctuations, which could harm our operating results in future periods.

Results of Operations

The following table sets forth statement of operations data as a percentage of total revenues for the periods indicated (unaudited):

	Three Months Ended		Six Months Ended	
	June 30, 2001	June 30, 2000	June 30, 2001	June 30, 2000
REVENUES:				
Product license	54%	73%	57%	74%
Services	46	27	43	26
Total revenues	100	100	100	100
Total cost of revenues	37	24	38	25
Gross margin	63	76	62	75
OPERATING EXPENSES:				
Research and development	23	13	22	14
Sales and marketing	76	44	73	47
General and administrative	17	15	19	16
Stock-based compensation	1	1	1	1
Restructuring	126	-	57	-
Total operating expenses	243	73	172	78
INCOME (LOSS) FROM OPERATIONS	(180)	3	(110)	(3)
INTEREST INCOME, NET	4	7	4	8
OTHER INCOME	1	-	-	-
Net income (loss) before provision for (benefit from) income taxes	(175)	10	(106)	5
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(56)	1	(36)	1
Net income (loss)	(119)%	9%	(70)%	4%

THREE AND SIX MONTHS ENDED JUNE 30, 2000 AND 2001

REVENUES

Total revenues increased 8% from $32.6 million for the three months ended June 30, 2000 to $35.1 million for the three months ended June 30, 2001. Total revenues increased 44% from $54.2 million for the six months ended June 30, 2000 to $77.9 million for the six months ended June 30, 2001. These increases were primarily attributable to market acceptance of our Dynamo suite of products as we continued to cultivate relationships with systems integrators and train our partner channels to encourage them to support our products. Additionally, global expansion and the release of our newest product offering, ATG Dynamo 5, in September 2000, contributed to our revenue growth. Revenues generated from international customers increased from $7.1 million for the three months ended June 30, 2000 to $12.0 million for the three months ended June 30, 2001 and from $9.5 million for the six months ended June 30, 2000 to $26.3 million for the six months ended June 30, 2001 due primarily to international expansion.

PRODUCT LICENSE REVENUES

Product license revenues decreased 20% from $23.8 million for the three months ended June 30, 2000 to $19.1 million for the three months ended June 30, 2001 and increased 11% from $40.1 million for the six months ended June 30, 2000 to $44.6 million for the six months ended June 30, 2001. The decrease for the three months ended June 30, 2001 was primarily due to the slowing economy and reduced IT spending among our customer base. The moderate increase for the six months ended June 30, 2001 was primarily attributable to growth in our partner channel, as well as increased sales to larger enterprises and international customers.

Product revenues as a percentage of total revenues for the three months ended June 30, 2000 and 2001 were 73% and 54%, respectively, and for the six months ended June 30, 2000 and 2001 were 74% and 57%, respectively. We anticipate product license revenues to decrease or remain flat for the remainder of 2001.

SERVICES REVENUES

Services revenues increased 82% from $8.8 million for the three months ended June 30, 2000 to $16.0 million for the three months ended June 30, 2001 and 136% from $14.1 million for the six months ended June 30, 2000 to $33.4 million for the six months ended June 30, 2001. Professional services revenue increased 37% from $4.6 million for the three months ended June 30, 2000 to $6.3 million for the three months ended June 30, 2001 and increased 88% from $7.3 million for the six months ended June 30, 2000 to $13.7 million for the six months ended June 30, 2001. The increase was primarily attributable to the continued growth of our service customer base and an increase in resources in our professional services group including the acquisition of The Toronto Technology Group Inc. in July 2000. Software maintenance and support revenues increased 168% from $3.1 million for the three months ended June 30, 2000 to $8.3 million for the three months ended June 30, 2001 and increased 253% from $4.7 million for the six months ended June 30, 2000 to $16.6 million for the six months ended June 30, 2001. The increase in software maintenance and support revenues was the result of continued increases in product revenues that generate software maintenance and support revenues and increases in software maintenance and support renewals. Training revenues increased 27% from $1.1 million for the three months ended June 30, 2000 to $1.4 million for the three months ended June 30, 2001 and increased 48% from $2.1 million for the six months ended June 30, 2000 to $3.1 million for the six months ended June 30, 2001. The increase was primarily attributable to our extended training program offerings. Additionally, our acquisition of Petronio Technology Group on May 17, 2000 provided us with additional Java, J2EE and XML courseware, as well as strengthened our training capabilities with the addition of seasoned trainers and curriculum developers. We believe these capabilities enhance our selling efforts for product license revenues to end-users, resellers and partners. We anticipate sequential service revenues to be flat or grow moderately for the remainder of 2001.

Services revenues as a percentage of total revenues for the three months ended June 30, 2000 and 2001 were 27% and 46%, respectively, and for the six months ended June 30, 2000 and 2001 were 26% and 43%, respectively. We expect services revenues to trend toward our target of approximately 30% of total revenues during 2002.

COST OF PRODUCT LICENSE REVENUES

Cost of license revenues increased 27% from $865,000 for the three months ended June 30, 2000 to $1.1 million for the three months ended June 30, 2001 and increased 31% from $1.6 million for the six months ended June 30, 2000 to $2.1 million for the six months ended June 30, 2001. These increases are primarily from increases in salary and benefit costs associated with sustaining the current release of the Dynamo suite of products. In February 2000, we settled a lawsuit filed by BroadVision in December 1998, which alleged that we were infringing on a patent for a method of conducting e-commerce. As part of the settlement, we, in return for cash payments, received a non-exclusive, worldwide, perpetual, paid-up license to make, use and sell products arguably covered by the patent and any other patents that may be issued in the future that are related to the original patent. We agreed to pay BroadVision a total of $15.0 million in license fees, which are being accounted for as cost of product license revenues. An initial payment of $8 million in February 2000 was expensed in the fourth quarter of 1999, and the remaining $7.0 million is being expensed ratably over a three-year period that began in the first quarter of 2000. For both the three months ended June 30, 2000 and 2001, we expensed $583,000 and for both the six months ended June 30, 2000 and 2001, we expensed $1,167,000.

COST OF SERVICES REVENUES

Cost of services revenues includes salary and other related costs for our professional services and technical support staff, as well as third-party contractor expenses. Cost of services revenues will vary significantly from year to year depending on the level of professional services staffing, the effective utilization rates of our professional services, the mix of services performed, including product license technical support services, the extent to which these services are performed by us or by third-party contractors, and the level of third-party contractors fees.

Cost of services revenues increased 74% from $6.9 million for the three months ended June 30, 2000 to $12.0 million for the three months ended June 30, 2001 and increased 131% from $11.9 million for the six months ended June 30, 2000 to $27.5 million for the six months ended June 30, 2001. The increase was attributable to the increase in resources in our professional services group. Approximately 69% and 58% of the increases for the three and six months ended June 30, 2001, respectively, were attributable to increased compensation costs due to increases in our work force. Additionally, 22% of the increase for the three months ended June 30, 2001 and 17% of the increase for the six months ended June 30, 2001 were related to increased facilities costs. Costs also increased due to increased travel.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses consist primarily of salary and related cost to support product development. To date, all software development costs have been expensed as research and development in the period incurred.

Research and development expenses increased 98% from $4.1 million for the three months ended June 30, 2000 to $8.1 million for the three months ended June 30, 2001 and increased 123% from $7.7 for the six months ended June 30, 2000 to $17.2 million for the six months ended June 30, 2001. Approximately 55% of the increase for the three months ended June 30, 2001 and 48% of the increase for the six months ended June 30, 2001 were related to salaries and related benefits. Additionally, approximately 35% of the increase for the three months ended June 30, 2001 and 33% of the increase for the six months ended June 30, 2001 were related to facilities expenses.

Research and development expenses as a percentage of total revenues for the three months ended June 30, 2000 and 2001 were 13% and 23%, respectively, and for the six months ended June 30, 2000 and 2001 were 14% and 22%, respectively. We anticipate that research and development expenses will remain relatively flat, and will fluctuate as a percentage of total revenues based upon the level of revenue.

SALES AND MARKETING EXPENSES

Sales and marketing expenses consist primarily of salaries, commissions and other related costs for sales and marketing personnel, travel, public relations and marketing materials and events.

Sales and marketing expenses increased 87% from $14.3 million for the three months ended June 30, 2000 to $26.7 million for the three months ended June 30, 2001 and increased 124% from $25.4 for the six months ended June 30, 2000 to $56.8 for the six months ended June 30, 2001. The increase was associated primarily with international sales and marketing expansion, global hiring, advertising efforts, branding and increased commissions. Approximately 58% and 52% of the increases, respectively, for the three and six months ended June 30, 2001 were related to compensation and benefit costs. Additionally, approximately 27% and 13% of the increases, respectively, for the three and six months ended June 30, 2001 were related to facilities expenses.

Sales and marketing expenses as a percentage of total revenues for the three months ended June 30, 2000 and 2001 were 44% and 76%, respectively, and for the six months ended June 30, 2000 and 2001 were 47% and 73%, respectively. We anticipate that sales and marketing expenses will decrease, and will fluctuate as a percentage of total revenues depending on the level and timing of global expansion, program spending, the rate at which newly hired sales personnel become productive and the level of revenue. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses consist primarily of salaries and other related costs for operations and finance employees and legal and accounting fees.

General and administrative expenses increased 16% from $5.0 million for the three months ended June 30, 2000 to $5.8 million for the three months ended June 30, 2001 and increased 74% from $8.7 million for the six months ended June 30, 2000 to $15.1 million for the six months ended June 30, 2001. The moderate increase for the three months ending June 30, 2001 was primarily related to compensation and benefits and professional services. Approximately 72% of the increase for the six months ended June 30, 2001 was related to compensation and benefits costs. This was driven by expansion both domestically and internationally.

General and administrative expenses as a percentage of total revenues for the three months ended June 30, 2000 and 2001 were 15% and 17%, and for the six months ended June 30, 2000 and 2001 were 16% and 19%, respectively. We anticipate that general and administrative expenses will decrease moderately for the remainder of 2001.

STOCK-BASED COMPENSATION

Since the fourth quarter of 1998, we have recorded total deferred stock compensation of approximately $4.9 million in connection with stock option grants. These amounts represent the difference between the exercise price of certain stock option grants and the deemed fair value for accounting purposes of our common stock at the time of such grants. Additionally, in July 2000, we recorded deferred stock-based compensation of $2.0 million for unvested stock options acquired in connection with the acquisition of The Toronto Technology Group Inc. We are amortizing these amounts over the vesting periods of the applicable options. In addition, these amounts have been reduced due to the recipients of these grants terminating employment with the Company.

Stock-based compensation expense increased 6% from $304,000 for the three months ended June 30, 2000 to $323,000 for the three months ended June 30, 2001 and increased 16% from $608,000 for the six months ended June 30, 2000 to $704,000 for the six months ended June 30, 2001. These increases were due to the timing of our recording of stock-based compensation and the options acquired in connection with the acquisition of the Toronto Technology Group, Inc. We expect stock-based compensation expense to decrease based on our workforce reduction in the second quarter of 2001.

RESTRUCTURING

In April 2001, we instituted a cost-savings plan designed to reduce expenses. In addition to a 12% workforce reduction, we consolidated certain global offices, temporarily reduced salaries and eliminated many discretionary expenses. In June 2001, we announced a corporate reorganization to further reduce expenses and strategically realign its worldwide sales and service structure. During the three months ended June 30, 2001, we recorded a $44.2 million restructuring charge due to a global slowdown in IT spending. This restructuring will reduce expenses and align investments with new strategies designed for future profitability and long-term revenue growth. This charge includes $37.6 million of facilities related costs, $4.7 million of employee severance, benefits and related costs, $851,000 of marketing costs, $254,000 of legal and accounting costs, and $914,000 of other costs. We anticipate that these cost-cutting initiatives will result in an annualized cost savings of approximately $80 million.

INTEREST INCOME, NET

Interest income decreased 43% from $2.3 million for the three months ended June 30, 2000 to $1.3 million for the three months ended June 30, 2001 and decreased 27% from $4.4 million for the six months ended June 30, 2000 to $3.2 million for the six months ended June 30, 2001. The decrease was due to the overall decrease in the average balance of cash and cash equivalents and marketable securities from the three and six months ended June 30, 2000 to the three and six months ended June 30, 2001. There was no interest expense for the three months ended June 30, 2000 and 2001. Interest expense increased from zero for the six months ended June 30, 2000 to $131,000 for the six months ended June 30, 2001. This interest was the result of our sale of receivables in September 2000, and was based on the terms of that agreement.

OTHER INCOME

Other income increased from zero for the three months ended June 30, 2000 to $329,000 for the three months ended June 30, 2001 and increased from zero for the six months ended June 30, 2000 to $170,000 for the six months ended June 30, 2001. This income primarily represents the foreign currency transaction gains and losses.

PROVISION FOR (BENEFIT FROM) INCOME TAXES, NET OPERATING LOSSES AND TAX CREDIT CARRYFORWARDS

For the three and six months ended June 30, 2001 we have a benefit from income taxes of $19.7 and $27.6 million, respectively, as a result of the losses for those periods, which we believe will be realizable in the future. These represent an effective tax rate of 34%. For both the three and six months ended June 30, 2000, we recorded a provision for income taxes of $500,000, which represents an effective tax rate of 15%.

We generated significant tax loss carryforwards during the six months ended June 30, 2001, which can be carried forward for 20 years. Under SFAS No. 109, *Accounting for Income Taxes*, we can only recognize a deferred tax asset for future benefit of our tax loss carryforward to the extent that it is more likely than not that this asset will be realized. In determining the realizability of this asset, we considered numerous factors, including historical profitability, estimated future taxable income and the industry in which we operate. Management believes that it is more likely than not that the future benefit of this asset will be realized.

As of December 31, 2000, we had net operating loss carryforwards of $42.2 million for federal income tax purposes and approximately $49.6 million for state tax purposes. Approximately $31.8 million of the federal and state income tax net operating loss carryforwards relate to the exercise of stock options, which are treated as compensation deductions for federal and state income tax purposes. We also have available research and development tax credit carryforwards of $642,000. The net operating loss and tax credit carryforwards will expire at various dates beginning 2011 for federal purposes and 2005 for state purposes, if not utilized. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating loss and tax credit carryforwards in the event of an "ownership change" of a corporation. Our ability to utilize net operating loss and tax credit carryforwards on an annual basis would be limited as a result of an "ownership change" as defined by Section 382 of the Internal Revenue Code. We have completed several financings since inception and believe that we have incurred ownership changes. We do not believe the ownership changes will have a material impact on our ability to utilize our net operating loss and tax credit carryforwards.

LIQUIDITY AND CAPITAL RESOURCES

Our capital requirements relate primarily to facilities, infrastructure for new hires and working capital. Historically, we have funded our cash requirements primarily through the public and private sale of equity securities, commercial credit facilities and capital leases. In 2000, we began to fund our cash requirements in part from operations. At June 30, 2001, we had $43.2 million in cash and cash equivalents and $51.7 million in marketable securities.

Cash used in operating activities was $37.5 million for the six months ended June 30, 2001. This represents an operating loss of $54.8 million, a benefit from income taxes of $27.6 million and changes in working capital items. This was partially offset by sources of cash from a reduction in accounts receivable of $12.4 million, and an increase in accrued restructuring current and accrued restructuring long term of $18.0 million and $19.0 million, respectively.

Our investing activities consisted primarily of capital expenditures of $12.6 million for six months ended June 30, 2001 and net proceeds from marketable securities of $39.3 million. Assets acquired consist principally of computer hardware and software, and leasehold improvements. Management expects total capital expenditures to be approximately $12.0 million over the next twelve months.

We have a revolving line of credit with a bank, under which we may borrow up to $12,500,000. Borrowings bear interest at the bank s prime rate (6.75% at June 30, 2001). The revolving line of credit is collateralized by substantially all of our assets. As of June 30, 2001 there was no availability under the line of credit. Effective July 23, 2001, we modified the terms of the line of credit with the bank to eliminate all of our financial covenants. As part of this modification, we agreed to provide 100% cash collateral for our outstanding letters of credit, which totalled $12,768,000 as of June 30, 2001.

Net cash provided by financing activities was $1.4 million for the six months ended June 30, 2001, principally representing proceeds from stock option exercises and the employee stock purchase plan, offset in part by the quarterly payments on the long-term obligation to BroadVision.

We believe that with our existing financial resources we will be able to meet our cash requirements for at least the next twelve months.

FACTORS THAT MAY AFFECT OUR OPERATING RESULTS AND STOCK PRICE

A NUMBER OF RISKS AND UNCERTAINTIES EXIST THAT COULD AFFECT OUR FUTURE OPERATING RESULTS, INCLUDING THE FOLLOWING:

RISKS RELATED TO OUR BUSINESS

WE EXPECT OUR LOSSES TO CONTINUE AND WE DO NOT BELIEVE WE WILL BE ABLE TO SUSTAIN OUR CURRENT REVENUE GROWTH RATE

We incurred a loss in the first and second quarters of 2001, and the second, third and fourth quarters of 2000 were our first profitable quarters since inception. We have incurred substantial costs to develop and enhance our technology and products, to recruit and train a marketing and sales group, and to establish an administrative organization. As of June 30, 2001, we had an accumulated deficit of $69.2 million. We anticipate that our operating expenses will increase as we continue to develop our technology, increase our sales and marketing activities, create and expand our distribution channels, expand our services capabilities and improve our operational and financial systems. Although our revenues have grown significantly, they have grown from a relatively small base and, as a result, we do not believe that we will be able to sustain the growth rates we have achieved in recent quarters. In addition, we believe the current United States economic downturn will continue to have an adverse effect on demand for our products and services, and therefore adversely affect our revenues as well. Because we have a limited operating history, particularly as a company that sells software products, we have difficulty predicting our future operating results and we cannot be certain that our revenues will grow at a rate that will allow us to maintain profitability. In addition, we cannot be certain that we will be able to sustain or increase profitability on a quarterly or annual basis.

WE EXPECT OUR REVENUES AND OPERATING RESULTS TO FLUCTUATE, AND THE PRICE OF OUR COMMON STOCK COULD FALL IF QUARTERLY RESULTS ARE LOWER THAN THE EXPECTATIONS OF SECURITIES ANALYSTS

Our revenues and operating results are likely to vary significantly from quarter to quarter. If our quarterly results fall below the expectations of securities analysts, the price of our common stock could fall. A number of factors are likely to cause variations in our operating results, including:

demand for our products and services;

the timing of sales of our products and services;

the timing of customer orders and product implementations;

unexpected delays in introducing new products and services;

increased expenses, whether related to sales and marketing, product development or administration;

changes in the rapidly evolving market for Internet customer relationship management solutions;

the mix of revenues derived from products and services;

timing of hiring and utilization of services personnel;

cost overruns related to fixed price services projects;

the mix of domestic and international sales and;

costs related to possible acquisitions of technologies or businesses.

Accordingly, we believe that quarter-to-quarter comparisons of our operating results are not necessarily meaningful. The results of one or a series of quarters shout not be relied upon as an indication of our future performance.

We plan to increase our operating expenses to expand our sales and marketing operations, develop new distribution channels, fund greater levels of research and development, broaden professional services and support and improve our operational and financial systems. If our revenues do not increase as quickly as these expenses, our operating results may suffer and our stock price may decline.

OUR LENGTHY SALES CYCLE MAKES IT DIFFICULT TO PREDICT OUR QUARTERLY RESULTS

Our long sales cycle, which can range from several weeks to several months or more, makes it difficult to predict the quarter in which sales may occur. We have a long sales cycle because we generally need to educate potential customers regarding the use and benefits of our products and services. Our sales cycle varies depending on the size and type of customer contemplating a purchase and whether we have conducted business with a potential customer in the past. In addition, we believe the current economic downturn in the United States has increased the average length of our sales cycle as customers have deferred implementing new e-commerce solutions. We may incur significant sales and marketing expenses in anticipation of licensing our products, and if we do not achieve the level of revenues we expected, our operating results will suffer and our stock price may decline. These potential customers frequently need to obtain approvals from multiple decision makers prior to making purchase decisions. Delays in sales could cause significant variability in our revenues and operating results for any particular period.

THE MARKET FOR INTERNET CUSTOMER RELATIONSHIP MANAGEMENT SOLUTIONS IS NEW AND RAPIDLY EVOLVING AND WE CANNOT BE CERTAIN THAT A VIABLE MARKET FOR OUR PRODUCTS WILL CONTINUE TO DEVELOP

The market for Internet customer relationship management solutions is new and rapidly evolving. We expect that we will continue to need intensive marketing and sales efforts to educate prospective customers and partners about the uses and benefits of our products and services. Accordingly, we cannot be certain that a viable market for our products is sustainable. Organizations that have already invested substantial resources in other methods of conducting business may be reluctant or slow to adopt a new approach that may replace, limit or compete with their existing systems.

THE MARKET FOR INTERNET CUSTOMER RELATIONSHIP MANAGEMENT SOLUTIONS IS INTENSELY COMPETITIVE, AND WE EXPECT COMPETITION TO INTENSIFY IN THE FUTURE

The market for Internet customer relationship management solutions is intensely competitive and we expect competition to intensify in the future as revenues generated from Internet commerce increase. This level of competition could reduce our revenues and result in increased losses or reduced profits. Our primary competition currently comes from in-house development efforts by potential customers or partners, as well as from other vendors of Web-based application software. We currently compete with Internet application software vendors such as Blue Martini, BroadVision and Vignette. We also compete with platform application server products and vendors such as BEA Systems, IBM's Websphere products, Microsoft, Netscape and the Netscape/Sun Microsystems Alliance, among others. Many of our competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do, and may be able to respond more quickly to new or changing opportunities, technologies and customer requirements. Also, many current and potential competitors have greater name recognition and more extensive customer bases that they can leverage to gain market share. These competitors may be able to undertake more extensive promotional activities, adopt more aggressive pricing policies and offer more attractive terms to purchasers than we can. Moreover, our current and potential competitors, such as Microsoft and the Netscape/Sun Microsystems Alliance, may bundle their products in a manner that may discourage users from purchasing our products. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to enhance their products and expand their markets. Accordingly, new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

WE DEPEND ON OUR RELATIONSHIP WITH SYSTEMS INTEGRATORS

Since our potential customers often rely on third-party systems integrators to develop, deploy and manage Web sites for conducting commerce on the Internet, we cultivate relationships with systems integrators in order to encourage them to support our products. If we do not adequately train a sufficient number of systems integrators or if systems integrators were to devote their efforts to integrating or co-selling different products, our revenues could be reduced and our operating results could be harmed.

WE WILL NEED TO IMPLEMENT AND IMPROVE OUR OPERATIONAL SYSTEMS AND HIRE ADDITIONAL SERVICE PROFESSIONALS ON A TIMELY BASIS IN ORDER TO MANAGE GROWTH

We have expanded our operations rapidly in recent years. We intend to continue to expand in the foreseeable future to pursue existing and potential market opportunities and to support our growing customer base. Rapid growth places a significant demand on our management and operational resources. In order to manage growth effectively, we must implement and improve our operational systems, procedures and controls on a timely basis. We plan in particular to expand our professional services capabilities to support increased product license sales. However, we cannot be certain that we will be able to attract a sufficient number of highly qualified service personnel. In addition, new service personnel will require training and it will take time for them to become productive. If we fail to improve operational systems or to expand our professional service capabilities in a timely manner, we could experience customer dissatisfaction, cost inefficiencies and lost revenue opportunities, which could harm our operating results.

COMPETITION WITH OUR RESELLER PARTNERS COULD LIMIT OUR SALES OPPORTUNITIES AND JEOPARDIZE THESE RELATIONSHIPS

We sell products through resellers and original equipment manufacturers. In some instances, we target our direct selling efforts toward markets that are also served by some of these partners. This competition may limit our ability to sell our products and services directly in these markets and may jeopardize, or result in the termination of, these relationships.

OUR BUSINESS MAY BE HARMED IF WE LOSE THE SERVICES OF EITHER JEET SINGH OR JOSEPH CHUNG, OUR CO-FOUNDERS, OR IF WE ARE UNABLE TO ATTRACT AND RETAIN OTHER KEY PERSONNEL

Our success depends largely on the skills, experience and performance of some key members of our management, particularly our co-founders Jeet Singh and Joseph Chung. If we lose one or more of our key employees, our business could be harmed. We have purchased, and are the beneficiaries of, insurance policies on the lives of Mr. Singh and Mr. Chung, each in the amount of $1,000,000. Proceeds under this insurance may not cover our losses. In addition, our future success will depend in large part on our ability to continue attracting and retaining highly skilled personnel. Like other software companies, we face intense competition for qualified personnel. We may not be successful in attracting, assimilating and retaining qualified personnel in the future. We are continuing our search for a new Chief Financial Officer to succeed Ann Brady who resigned from the position of Chief Financial Officer effective July 1, 2001.

WE NEED TO EXPAND OUR SALES AND DISTRIBUTION CAPABILITIES IN ORDER TO INCREASE MARKET AWARENESS OF OUR PRODUCTS AND INCREASE OUR REVENUES

We must expand our direct and indirect sales operations to increase market awareness of our products and generate increased revenues. We may not be successful in these efforts. We have recently expanded our direct sales force and plan to hire additional sales personnel. Our products and services require a sophisticated sales effort targeted at the senior management of our prospective customers. Newly-hired employees will require training and it will take time for them to achieve full productivity. We may be unable to hire enough qualified individuals in the future, and newly hired employees may not achieve necessary levels of productivity.

WE COULD INCUR SUBSTANTIAL COSTS DEFENDING OUR INTELLECTUAL PROPERTY FROM INFRINGEMENT OR A CLAIM OF INFRINGEMENT

Our Innovation Solutions services often involve the development of custom software applications for specific customers. In some cases, customers retain ownership or impose restrictions on our ability to use the technologies developed from these projects. Issues relating to the ownership of software can be complicated, and disputes could arise that affect our ability to resell or reuse applications we develop for customers.

We seek to protect the source code for our proprietary software both as a trade secret and as a copyrighted work. However, because we make the source code available to some customers, third parties may be more likely to misappropriate it. Our policy is to enter into confidentiality agreements with our employees, consultants, vendors and customers and to control access to our software, documentation and other proprietary information. Despite these precautions, it may be possible for someone to copy our software or other proprietary information without authorization or to develop similar software independently.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. We could incur substantial costs to prosecute or defend any intellectual property litigation. If we sue to enforce our rights, the litigation would be expensive, would divert management resources and may not prevent the other parties from using our intellectual property without permission. In February 2000, we settled a lawsuit filed by BroadVision, which alleged that we were infringing on a patent for a method of conducting e-commerce. As part of the settlement, we agreed to pay BroadVision a total of $15.0 million in license fees over a three-year period, of which $12.0 million had been paid as of June 30, 2001.

In addition, we have agreed to indemnify customers against claims that our products infringe the intellectual property rights of third parties. The results of any intellectual property litigation to which we might become a party may force us to do one or more of the following:

- cease selling or using products or services that incorporate the challenged intellectual property;
- obtain a license, which may not be available on reasonable terms, to sell or use the relevant technology; or
- redesign those products or services to avoid infringement.

IF WE FAIL TO ADAPT TO RAPID CHANGES IN THE MARKET FOR INTERNET CUSTOMER RELATIONSHIP MANAGEMENT SOFTWARE, OUR EXISTING PRODUCTS COULD BECOME OBSOLETE

The market for our products is marked by rapid technological change, frequent new product introductions and Internet-related technology enhancements, uncertain product life cycles, changes in customer demands and evolving industry standards. We may not be able to develop and market new products or product enhancements that comply with present or emerging Internet technology standards. New products based on new technologies or new industry standards could render our existing products obsolete and unmarketable. To succeed, we will need to enhance our current products and develop new products on a timely basis to keep pace with developments related to Internet technology and to satisfy the increasingly sophisticated requirements of customers. E-commerce technology is complex and new products and product enhancements can require long development and testing periods. Any delays in developing and releasing enhanced or new products could cause us to lose revenue opportunities and customers.

OUR BUSINESS MAY SUFFER IF WE FAIL TO ADDRESS THE CHALLENGES ASSOCIATED WITH INTERNATIONAL OPERATIONS

We have recently begun to invest significant financial and managerial resources to expand our sales and marketing operations in international markets. We currently maintain offices in Australia, Canada, England, France, Germany, Hong Kong, Japan, the Netherlands, Singapore and Sweden. We derived 34% of our total revenues from customers outside the United States for the three months ended June 30, 2001. We anticipate that revenues from customers outside the United States will account for an increased portion of our total revenues for the foreseeable future. To date, however, we have limited experience in international operations and may not be able to compete successfully in international markets. Our operations outside North America are subject to additional risks, including:

- unexpected changes in regulatory requirements, exchange rates, tariffs and other barriers;
- longer payment cycles and problems in collecting accounts receivable;
- political and economic instability;
- difficulties in managing system integrators and technology partners;
- difficulties in staffing and managing foreign subsidiary operations;
- differing technology standards;
- difficulties and delays in translating products and product documentation into foreign languages;
- reduced protection for intellectual property rights in some of the countries in which we operate or plan to operate;
- problems associated with the conversion of various European currencies into a single currency, the euro; and
- potentially adverse tax consequences.

The impact of future exchange rate fluctuations on our operating results cannot be accurately predicted. We may increase the extent to which we denominate arrangements with international customers in the currencies of the countries in which the software or services are provided. From time to time we may engage in hedges of a significant portion of contracts denominated in foreign currencies. Any hedging policies implemented by us may not be successful, and the cost of these hedging techniques may have a significant negative impact on our operating results.

WE USE THE JAVA PROGRAMMING LANGUAGE TO DEVELOP OUR PRODUCTS, AND OUR BUSINESS COULD BE HARMED IF JAVA LOSES MARKET ACCEPTANCE OR IF WE ARE NOT ABLE TO CONTINUE USING JAVA OR JAVA-RELATED TECHNOLOGIES

We write our software in the Java computer programming language developed by Sun Microsystems. While a number of companies have introduced Web applications based on Java, Java could fall out of favor, and support by Sun Microsystems or other companies could decline. Moreover, our new Dynamo 5 e-Business Platform is designed to support Sun s Java 2 Platform, Enterprise Edition, or J2EE, standards for developing modular Java programs that can be accessed over a network. We have licensed the J2EE brand and certification tests from Sun. There can be no assurance that these standards will be widely adopted, that we can continue to support J2EE standards established by Sun from time to time or that the J2EE brand will continue to be made available to us on commercially reasonable terms. If Java or J2EE support decreased or we could not continue to use Java or related Java technologies or to support J2EE, we might have to rewrite the source code for our entire product line to enable our products to run on other computer platforms. Also, changes to Java or J2EE standards or the loss of our license to the J2EE brand could require us to change our products and adversely affect the perception of our products by our customers. If we were unable to develop or implement appropriate modifications to our products on a timely basis, we could lose revenue opportunities and our business could be harmed.

OUR SOFTWARE PRODUCTS MAY CONTAIN ERRORS OR DEFECTS THAT COULD RESULT IN LOST REVENUES, DELAYED OR LIMITED MARKET ACCEPTANCE, OR PRODUCT LIABILITY CLAIMS WITH SUBSTANTIAL LITIGATION COSTS

Complex software products such as ours often contain errors or defects, particularly when first introduced or when new versions or enhancements are released. We began shipping our new application suite, Dynamo 5 e-business Platform, in September 2000. Despite internal testing and testing by customers, our current and future products may contain serious defects. Serious defects or errors could result in lost revenues or a delay in market acceptance.

Since our customers use our products for critical business applications such as e-commerce, errors, defects or other performance problems could result in damage to our customers. They could seek significant compensation from us for the losses they suffer. Although our license agreements typically contain provisions designed to limit our exposure to product liability claims, existing or future laws or unfavorable judicial decisions could negate these limitations. Even if not successful, a product liability claim brought against us would likely be time-consuming and costly.

IF WE ACQUIRE OTHER COMPANIES OR BUSINESSES, WE WILL BE SUBJECT TO RISKS THAT COULD HURT OUR BUSINESS

We acquired Petronio Technology Group in May 2000 for consideration of approximately $1.2 million and the Toronto Technology Group in July 2000 for consideration of approximately $12.0 million. In the future, we may pursue additional acquisitions to obtain complementary businesses, products, services or technologies. An acquisition may not produce the revenues, earnings or business synergies that we anticipated, and an acquired business, product, service or technology might not perform as we expected. If we pursue an acquisition, our management could spend a significant amount of time and effort in identifying and completing the acquisition. If we complete an acquisition, we may encounter significant difficulties and incur substantial expense in integrating the operations and personnel of the acquired company into our operation while preserving the goodwill of the acquired company. In particular, we may lose the services of key employees of the acquired company and we may make changes in management that impair the acquired company s relationships with employees and customers.

Any of these outcomes could prevent us from realizing the anticipated benefits of our acquisitions. To pay for an acquisition, we might use stock or cash. Alternatively, we might borrow money from a bank or other lender. If we use our stock, our stockholders would experience dilution of their ownership interests. If we use cash or debt financing, our financial liquidity would be reduced. Finally, if we are unable to account for our acquisitions under the pooling-of-interests method of accounting, which may be eliminated, we may be required to capitalize a significant amount of intangibles, including goodwill, which may lead to significant amortization charges. In addition, we may incur significant, one-time write-offs and amortization charges. These amortization charges and write-offs could decrease our future earnings or increase our future losses.

RISKS RELATED TO THE INTERNET INDUSTRY

OUR PERFORMANCE WILL DEPEND ON THE GROWTH OF E-COMMERCE

Our success will depend heavily on the acceptance and wide use of the Internet for e-commerce. The current United States economic downturn has reduced demand for our products as customers and potential customers delay or cancel the implementation of customer relationship management solutions. Consumers and businesses may reject the Internetas a viable commercial medium for a number of reasons, including potentially inadequate network infrastructure, slow development of enabling technologies, insufficient commercial support or privacy concerns. The Internet infrastructure may not be able to support the demands placed on it by increased usage. In addition, delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity, or increased government regulation could cause the Internet to lose its viability as a commercial medium. Even if the required infrastructure, standards, protocols and complementary products, services or facilities are developed, we may incur substantial expenses adapting our solutions to changing or emerging technologies.

REGULATIONS COULD BE ENACTED THAT EITHER DIRECTLY RESTRICT OUR BUSINESS OR INDIRECTLY IMPACT OUR BUSINESS BY LIMITING THE GROWTH OF E-COMMERCE

As e-commerce evolves, federal, state and foreign agencies could adopt regulations covering issues such as user privacy, content and taxation of products and services. If enacted, government regulations could limit the market for our products and services or could impose burdensome requirements that render our business unprofitable. Although many regulations might not apply to our business directly, we expect that laws regulating the solicitation, collection or processing of personal and consumer information could indirectly affect our business. The Telecommunications Act of 1996 prohibits certain types of information and content from being transmitted over the Internet. The prohibition's scope and the liability associated with a violation are currently unsettled. In addition, although substantial portions of the Communications Decency Act were held to be unconstitutional, we cannot be certain that similar legislation will not be enacted and upheld in the future. It is possible that legislation could expose companies involved in e-commerce to liability, which could limit the growth of e-commerce generally. Legislation like the Telecommunications Act and the Communications Decency Act could dampen the growth in Web usage and decrease its acceptance as a medium of communications and commerce.

THE INTERNET IS GENERATING PRIVACY CONCERNS WHICH COULD RESULT IN LEGISLATION OR MARKET PERCEPTIONS THAT COULD HARM OUR BUSINESS OR RESULT IN REDUCED SALES OF OUR PRODUCTS, OR BOTH

Businesses use our Dynamo Personalization Server product to develop and maintain profiles to tailor the content to be provided to Web site visitors. When a visitor first arrives at a Web site, our software creates a profile for that visitor. If the visitor registers or logs in, the visitor's identity is added to the profile, preserving any profile information that was gathered up to that point. Dynamo Personalization Server tracks both explicit user profile data supplied by the user as well as implicit profile attributes derived from the user's behavior on the Web site. Privacy concerns may cause visitors to resist providing the personal data or avoid Web sites tracking the Web behavioral information necessary to support this profiling capability. More importantly, even the perception of security and privacy concerns, whether or not valid, may indirectly inhibit market acceptance of our products. In addition, legislative or regulatory requirements may heighten these concerns if businesses must notify Web site users that the data captured after visiting Web sites may be used to direct product promotion and advertising to that user. Other countries and political entities, such as the European Economic Community, have adopted such legislation or regulatory requirements. The United States may adopt similar legislation or regulatory requirements. If privacy legislation is enacted or consumer privacy concerns are not adequately addressed, our business, financial condition and operating results could be harmed.

Our products use "cookies" to track demographic information and user preferences. A "cookie" is information keyed to a specific user that is stored on a computer's hard drive, typically without the user's knowledge. Cookies are generally removable by the user, although removal could affect the content available on a particular site. Germany has imposed laws limiting the use of cookies, and a number of Internet commentators and governmental bodies in the United States and other countries have urged passage of laws limiting or abolishing the use of cookies. If such laws are passed or if users begin to delete or refuse cookies as a common practice, demand for our personalization products could be reduced.

PROJECTIONS INCLUDED IN THIS QUARTERLY REPORT RELATING TO THE GROWTH OF E-COMMERCE AND THE INTERNET ARE BASED ON ASSUMPTIONS THAT COULD TURN OUT TO BE INCORRECT AND ACTUAL RESLULTS COULD BE MATERIALLY DIFFERENT FROM THE PROJECTIONS

This quarterly report contains various data and projections related to revenues generated by electronic commerce and the size of the worldwide Internet commerce application software market. These data and projections are inherently imprecise, and investors are cautioned not to place undue reliance on them. These data and projections have been included in studies prepared by International Data Corporation, an independent market research firm, and the projections are based on surveys, financial reports and models used by IDC to measure license revenues and associated maintenance fees derived from sales to e-commerce sites. These projections include assumptions regarding business and home use of the Internet, including assumptions as to growth in the percentage of Web users making online purchases, increases in the amount of time people spend using the Web, changing attitudes toward Web usage and purchasing, levels of business saturation for Web use and increases in the level of software spending by businesses, as well as various assumptions regarding the rate of growth of Web use in countries outside the United States. Actual results or circumstances may be materially different from the projections.

RISKS RELATED TO THE SECURITIES MARKET

OUR STOCK PRICE MAY CONTINUE TO BE VOLATILE

The market price of our common stock has fluctuated in the past and is likely to continue to be highly volatile. For example, the market price of our common stock has ranged from $1.82 per share to $126.88 per share since our initial public offering in July 1999. Fluctuations in market price and volume are particularly common among securities of Internet and software companies. The market price of our common stock may fluctuate significantly in response to the following factors, some of which are beyond our control:

- variations in our quarterly operating results;
- changes in market valuations of Internet and software companies;
- our announcements of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- our failure to complete significant sales;
- additions or departures of our key personnel;
- future sales of our common stock; or
- changes in financial estimates by securities analysts.

WE MAY INCUR SIGNIFICANT COSTS FROM CLASS ACTION LITIGATION

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its stock. We may be the target of similar litigation in the future. Securities litigation could result in substantial costs and divert management s attention and resources.

OUR EXECUTIVE OFFICERS AND DIRECTORS WILL BE ABLE TO INFLUENCE MATTERS REQUIRING STOCKHOLDER APPROVAL AND COULD DELAY OR PREVENT SOMEONE FROM ACQUIRING OR MERGING WITH US ON TERMS FAVORED BY A MAJORITY OF OUR INDEPENDENT STOCKHOLDERS

Our executive officers and directors beneficially owned approximately 18.9% of our common stock as of July 31, 2001. As a result, these stockholders may be able to influence matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This could delay or prevent someone from acquiring or merging with us.

ANTI-TAKEOVER PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW COULD PREVENT OR DELAY A CHANGE IN CONTROL OF OUR COMPANY

Certain provisions of our certificate of incorporation and by-laws may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable, which could reduce the market price of our common stock. These provisions include:

- authorizing the issuance of blank check preferred stock;
- providing for a classified board of directors with staggered, three-year terms;
- providing that directors may only be removed for cause by a two-thirds vote of stockholders;
- limiting the persons who may call special meetings of stockholders prohibiting stockholder action by written consent; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

Delaware law may also discourage, delay or prevent someone from acquiring or merging with us.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The majority of our operations are based in the U.S. and, accordingly, the majority of our transactions are denominated in U.S. dollars. However, we have foreign based operations where transactions are denominated in foreign currencies and are subject to market risk with respect to fluctuations in the relative value of currencies. The impact of fluctuations in the relative value of other currencies was not material for the three and six months ended June 30, 2001. We do not use derivative financial instruments for investment purposes and only invest in financial investments that meet high credit quality standards, as specified in the our investment policy guidelines; the policy also limits the amount of credit exposure to any one issue, issuer, and type of instrument.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

We held our Annual Meeting of Stockholders on May 14, 2001. At the meeting, Scott A. Jones and Thomas N. Matlack were reelected as Class II Directors. The vote with respect to each nominee is set forth below:

	Total Vote for Each Director	Total Vote Withheld From Each Director
Mr. Jones	56,942,163	834,384
Mr. Matlack	50,665,477	7,111,070

Additional Directors of the Company whose terms of office continued after the meeting are Joseph T. Chung, Jeet Singh, Phyllis S. Swersky and Robert F. Walters.

The stockholders also approved an amendment of our Amended and Restated 1996 Stock Option Plan to increase by 6,600,000 shares to 25,600,000 shares, the number of shares of common stock authorized for issuance under this Plan, by a vote of 27,457,300 shares for, 15,820,347 shares against and 146,933 shares abstaining, with 14,351,968 broker non-votes.

In addition, the stockholders approved an amendment to our By-laws to authorize the use of electronic and remote communications for specific corporate purposes by a vote of 57,609,625 shares for, 24,688 shares against, and 142,234 shares abstaining.

The stockholders also ratified the selection of Aurther Andersen LLP as our independent auditors by a vote of 57,455,984 shares for, 192,836 shares against and 127,727 shares abstaining.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1 Third Loan Modification Agreement dated July 23, 2001 between Silicon Valley Bank and the Registrant.

(b) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, as of August 14, 2001.

ART TECHNOLOGY GROUP, INC.
(Registrant)

By: /s/ Jeet Singh

Jeet Singh
Chief Executive Officer

By: /s/ Joseph T. Chung

Joseph T. Chung
Chairman of the Board, Chief Technology Officer and Treasurer