ART TECHNOLOGY GROUP INC
Form 10-Q
November 15, 2002

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 September 30, 2002

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	**04-3141918**

(State or other jurisdiction of incorporation or organization)	(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 November 7, 2002 there were 70,475,324 shares of the Registrant s common stock outstanding.

ART TECHNOLOGY GROUP, INC.

INDEX TO FORM 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ART TECHNOLOGY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(UNAUDITED)

	September 30, 2002	December 31, 2001
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 47,010	$ 49,493
Marketable securities	20,847	14,057
Accounts receivable, net of reserves of approximately $1,518 and $3,539 at September 30, 2002 and December 31, 2001, respectively	20,412	30,532
Unbilled services	798	274
Prepaid expenses and other current assets	5,973	5,541
Total Current Assets	95,040	99,897
Restricted cash	4,604	16,757
Property and Equipment, Net	11,204	16,171
Other Assets	1,520	4,663
	$ 112,368	$ 137,488
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current maturities of long-term obligations	$ 500	$ 2,000
Accounts payable	4,626	4,160
Accrued expenses	18,981	24,718
Deferred revenue	13,646	17,628
Accrued restructuring, short-term	9,125	13,398
Total Current Liabilities	46,878	61,904
Accrued restructuring, less current portion	28,779	32,675

Commitments and Contingencies				
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 70,460,324 shares and 68,982,030 shares at September 30, 2002 and December 31, 2001 respectively		704		689
Additional paid-in capital		216,944		214,597
Deferred compensation		(586)		(1,558)
Accumulated deficit		(179,035)		(170,379)
Accumulated other comprehensive income		(1,316)		(440)
Total Stockholders Equity		36,711		42,909
	$	112,368	$	137,488

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

ART TECHNOLOGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Revenues:				
Product licenses	$ 11,825	$ 13,411	$ 36,574	$ 57,975
Services	12,677	17,042	40,403	51,267
Total Revenues	24,502	30,453	76,977	109,242
Cost of Revenues:				
Product licenses	1,118	1,075	3,257	3,222
Services	8,119	10,546	25,941	38,941
Total Cost of Revenues	9,237	11,621	29,198	42,163
Gross Profit	15,265	18,832	47,779	67,079
Operating Expenses:				
Research and development	5,419	7,218	16,552	24,397
Sales and marketing	9,713	20,506	33,269	77,341
General and administrative	3,021	5,299	7,778	20,359
Stock-based compensation	246	298	774	1,002
Restructuring			(89)	44,235
Total Operating Expenses	18,399	33,321	58,284	167,334
Loss from Operations	(3,134)	(14,489)	(10,505)	(100,255)
Interest and Other Income, Net	77	809	1,849	4,161
Net loss before benefit from income taxes	(3,057)	(13,680)	(8,656)	(96,094)
Benefit from Income Taxes		(4,651)		(32,273)
Net loss	$ (3,057)	$ (9,029)	$ (8,656)	$ (63,821)
Basic and diluted net loss per share	$ (0.04)	$ (0.13)	$ (0.12)	$ (0.93)

Basic and diluted weighted average common shares outstanding	69,954	68,762	69,737	68,512

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

ART TECHNOLOGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	Nine Months Ended	
	September 30, 2002	**September 30, 2001**
Cash Flows from Operating Activities:		
Net loss	$ (8,656)	$ (63,821)
Adjustments to reconcile net loss to net cash used in operating activities		
Stock-based compensation	774	1,002
Depreciation and amortization	5,430	6,763
Loss on disposal of fixed assets, net	633	4,985
Benefit from income taxes		(32,273)
Compensation expense related to issuance of restricted shares		2,574
Changes in current assets and liabilities		
Accounts receivable, net	10,120	21,491
Unbilled services	(524)	832
Prepaid expenses and other current assets	(432)	(3,244)
Restricted cash	12,153	(16,757)
Accounts payable	466	(7,800)
Accrued expenses	(5,737)	(5,646)
Deferred revenues	(3,982)	(4,836)
Accrued restructuring	(8,169)	30,228
Net cash provided by (used in) operating activities	2,076	(66,502)
Cash Flows from Investing Activities:		
Proceeds from (purchases of) marketable securities, net	(6,790)	64,416
Purchases of property and equipment	(843)	(12,499)
Decrease in other assets	3,143	2,015
Net cash (used in) provided by investing activities	(4,490)	53,932
Cash Flows from Financing Activities:		
Tudor Settlement (Footnote 11)	1,050	
Proceeds from exercise of stock options	108	1,085
Proceeds from employee stock purchase plan	1,402	1,534
Payments on long-term obligations	(1,500)	(1,500)
Net cash provided by financing activities	1,060	1,119

Effect of Foreign Exchange Rate Changes on Cash and Cash Equivalents		(1,129)		(103)
Net Decrease in Cash and Cash Equivalents		(2,483)		(11,554)
Cash and Cash Equivalents, Beginning of Period		49,493		53,255
Cash and Cash Equivalents, End of Period	$	47,010	$	41,701

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

ART TECHNOLOGY GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED 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. ATG 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 unaudited condensed 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 footnotes required by accounting principles generally accepted in the United States. 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 2001 Annual Report and Form 10-K. In the opinion of management, the accompanying unaudited condensed consolidated financial statements and notes contain all adjustments, consisting of normal recurring accruals, considered 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 nine months ended September 30, 2002 are not necessarily indicative of the results to be expected for the full year ending December 31, 2002.

The accompanying unaudited condensed consolidated 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

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) available for common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) available for common stockholders by the weighted average number of shares of common stock outstanding, including potential common shares from exercise of stock options and warrants using the treasury stock method, if dilutive.

Options to purchase a total of 11,923,728 shares as of September 30, 2002 and 13,765,375 shares of common stock and 18,745 shares of restricted stock as of September 30, 2001, have been excluded from the computation of diluted weighted average shares outstanding, as the effect of their inclusion would have been antidilutive.

3. REVENUE RECOGNITION

ATG recognizes product license revenue from licensing the rights to use its software to third parties. ATG also generates service revenue 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 governing the terms and conditions of its software license, 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 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. For the three months ended September 30, 2002 one customer represented 10% to 15% of the Company s total revenues.

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 quarter. 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* (SFAS No. 115). 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 maturities at date of purchase of ninety days or less. Marketable securities are investment grade securities with maturities at date of purchase of greater than ninety days. The average maturity of the Company s marketable securities was approximately 4.8 months and 4.3 months at September 30, 2002 and December 31, 2001, respectively. At September 30, 2002 and December 31, 2001, the difference between the amortized cost and market value of ATG s marketable securities was approximately $24,000 and $163,000. Restricted cash represents the portion of ATG's outstanding letters of credit that are cash collateralized as of September 30, 2002 and December 31, 2001 (see Note 6).

		September 30, 2002		December 31, 2001
		(in thousands)		
Cash and cash equivalents				
Cash	$	7,655	$	10,518
Money market accounts		40,296		38,975
Total cash and cash equivalents	$	47,951	$	49,493
Marketable securities				
Corporate securities	$	20,847	$	14,057
Total marketable securities	$	20,847	$	14,057
Restricted cash				
Restricted cash	$	4,604	$	16,757
Total restricted cash	$	4,604	$	16,757

6. 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 and $2,000,0000 during the year ended December 31, 2000 and 2001, respectively. ATG paid $1,500,000 through the nine months ended September 30, 2002 and will pay the remaining $500,000 in the quarter ending December 31, 2002, which is included in the accompanying condensed consolidated balance sheet in current maturities of long-term obligations.

Throughout 2001, ATG had a working capital line-of-credit agreement with Silicon Valley Bank, which provided for borrowings of up to the lesser of $12,500,000, or 80%, of eligible accounts receivable (as defined). The line of credit bore interest at the bank s prime rate (4.75% at December 31, 2001) and expired in December 2001.

Effective June 13, 2002, ATG entered into a $15 million revolving line of credit with the bank which provides for borrowings of up to the lesser of $15 million or 80% of eligible accounts receivable. The line of credit bears interest at the bank's prime rate (4.75% at September 30, 2002). As of September 30, 2002, approximately $1,597,000 was available for future borrowings. The line of credit is secured by all of the Company's tangible and intangible intellectual and personal property and is subject to financial covenants including liquidity coverage and profitability. Effective September 27, 2002 the revolving line of credit was modified to, among other things, increase the amount of the allowable quarterly net loss for the quarter ended September 30, 2002 from $3 million to $4.5 million. As of September 30, 2002, ATG is in compliance with all related financial covenants. While there were no outstanding borrowings under the facility at September 30, 2002, the Company has issued letters of credit (LC's) totaling $11.3 million, which are supported by this facility. During the term of the credit facility, ATG is no longer required to fully cash secure all of its LC's. However, the Company is required to maintain $18 million of unrestricted cash with the bank at all times during the term of the line of credit. As a result of this requirement, this revolving line of credit does not increase the amount of net cash available to the Company during the term of the agreement. The revolving line of credit expires on December 27, 2002. In the event that the Company does not comply with any of the covenants within the line of credit or defaults on any of its provisions, the bank's significant remedies include, 1) declaring all obligations immediately due and payable; 2) ceasing to advance money or extend credit for ATG's benefit, and; 3) apply to the obligations any balances and deposits held by ATG or any amount held by the bank owing to or for the credit or the account of ATG. If the agreement expires, or is not extended, the bank will require outstanding LC's at that time to be cash secured on terms acceptable to the bank.

As of September 30, 2002, ATG had commitments totaling approximately $15,875,000 in the form of outstanding LC s in favor of ATG s various landlords to secure obligations under ATG s facility leases. As of September 30, 2002, $4,604,000 of the LC s were cash collateralized. At December 31, 2001, the Company had commitments totaling approximately $16,757,000 of outstanding LC's in favor of ATG's various landlords to secure obligations under the Company's facility leases. All of these LC's were fully cash collateralized as of December 31, 2001.

7. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is comprised of two components, net income (loss) and other comprehensive income (loss) representing items recorded directly within stockholders equity. The following were the components of ATG s comprehensive loss (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2002	**September 30, 2001**	**September 30, 2002**	**September 30, 2001**
Net loss	$ (3,057)	$ (9,029)	$ (8,656)	$ (63,821)
Foreign currency translation loss (gain)	249	(117)	(876)	(272)
Comprehensive loss	$ (2,808)	$ (9,146)	$ (9,532)	$ (64,093)

The accumulated other comprehensive loss at September 30, 2002 and December 31, 2001 of $1,316,000 and $440,000, respectively, consisted entirely of the cumulative foreign currency translation adjustment.

8. 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 for which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in order to assess performance and allocate resources. ATG s chief operating decision-makers, as defined under SFAS No. 131, are the members of its executive management team. To date, the Company has viewed its operations and manages its business as principally one segment with two major offerings: software licenses and services. ATG 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 $7,471,000 and $11,754,000 for the three months ended September 30, 2002 and 2001, respectively, and $22,912,000 and $38,074,000 for the nine months ended September 30, 2002 and 2001, respectively. ATG s revenue from international sources were primarily generated from customers located in Europe, Canada and Asia Pacific. All of ATG s software license sales for the three and nine months ended September 30, 2002 and 2001 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		Nine Months Ended	
	September 30, 2002	**September 30, 2001**	**September 30, 2002**	**September 30, 2001**
United States	70%	61%	70%	65%
United Kingdom (UK)	20	9	19	12
Germany	4	11	4	7
Europe, Middle East and Africa (excluding UK and Germany)	1	12	3	10
Other	5	7	4	6
	100%	100%	100%	100%

9. COMMITMENTS AND CONTINGENCIES

In August 1999, ATG entered into a new facility lease for its corporate headquarters that expires in August 2006. Upon occupancy of the new facility, ATG issued the lessor a letter of credit in the amount of $1,500,000. Additionally, ATG has offices, primarily for sales and support personnel, in eight domestic locations as well as ten foreign countries.

The approximate future minimum payments of ATG s facility leases and certain operating equipment leases as of September 30, 2002 are as follows:

Years Ending September 30		**Operating Leases (in thousands)**
Remainder of 2002	$	4,186
2003		16,812
2004		15,444
2005		16,145
2006		14,085
Thereafter		28,272
	$	94,944

Of the $94.9 million in future minimum lease payments, $56.7 million is included in the Company s restructuring accrual at September 30, 2002. The $56.7 million is reduced to $37.6 million taking into consideration estimated sublease income and vacancy periods as of September 30, 2002 (see Note 10).

ATG s German subsidiary, Art Technology Group GmbH, has been named a defendant in a breach of contract lawsuit filed in Germany on July 18, 2002 based on a claim that the subsidiary failed to pay rent of 1.4 million euros (approximately $1,403,920 as of November 7, 2002) plus 8% interest on certain office space and failed to provide a guarantee of 675,000 euros (approximately $676,890 as of November 7, 2002), (see Note 11).

10. RESTRUCTURING

ATG undertook plans to restructure its operations during 2001 as a result of a global slowdown in information technology spending. Actions taken by ATG included: consolidation of excess facilities, a worldwide workforce reduction, the write-off of certain unrealizable assets and settling certain obligations that had no future benefit. In the second quarter of 2001, ATG recorded a restructuring charge of $44.2 million, and in the fourth quarter of 2001, ATG recorded a restructuring charge of $32.7 million. Total restructuring charges for 2001 were $76.9 million.

The significant components of the restructuring charges were as follows (in thousands):

RESTRUCTURING CHARGES

		Twelve Months Ended December 31, 2001		**Payments or Write-Offs in 2001**		**Accrued Restructuring Charges as of December 31, 2001**		**Payments in the Nine Months Ended September 30, 2002**		**Accrued Restructuring Charges as of September 30, 2002**
Facilities-related costs	$	60,918	$	16,208	$	44,710	$	7,076	$	37,634

Employee severance, benefits and related costs	7,938	6,748	1,190	920	270
Asset impairments	5,570	5,570			
Exchangeable share settlement	1,263	1,263			
Marketing costs	851	851			
Legal and accounting costs	405	232	173	173	
Total	$ 76,945	$ 30,872	$ 46,073	$ 8,169	$ 37,904

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 estimated the vacancy period and sublease income. A component of the fourth quarter facility-related cost was a change in estimate of the second quarter facility-related restructuring charge. The net change in estimate was an additional charge of $1.5 million in the fourth quarter. Of the $1.5 million charge, a credit of $8.2 million was realized due to the termination buy-out of a certain lease included in the second quarter charge of $9.3 million, which is being paid ratably over 4.5 years. This credit was offset by an increase of approximately $9.7 million due to updated assumptions, as a result of a market analysis indicating lower sublease rates and higher vacancy periods for two leases provided for in the second quarter. Included in the facility-related costs was the write-off of abandoned leasehold improvements and fixed assets of $7.7 million and $2.2 million, respectively. These fixed assets were directly related to the restructured excess office facilities.

The employee severance cost component of the restructuring charge was related to reductions in personnel. As part of the restructuring, ATG terminated the employment of 530 employees, or 46% of its workforce. Approximately 47% of these employees were from sales and marketing, 22% from services, 19% from general and administrative, and 12% from research and development.

The asset impairment costs included the write-off of the remaining unamortized goodwill of approximately $4.0 million, which was related to two professional service acquisitions completed in 2000. In addition the Company determined that approximately $1.4 million of purchased software was impaired due to the Company s revised product development strategy.

ATG settled 11,762 exchangeable shares with a certain employee. Upon settlement, the company recorded $1.3 million as a charge to restructuring.

During the second quarter of 2002 ATG recorded a net change increasing the restructured lease obligation accruals by $447,000. The Company increased one lease obligation estimate by $1.3 million as a result of adjusting the estimated sublease income and vacancy assumptions due to the continued weakening of the real estate market in that location. Offsetting this increase, ATG recognized a benefit of $853,000 from two other restructured lease obligation accruals due to favorable sublease transactions consummated during the current quarter. This net charge has been offset by the Company receiving a refund of $536,000 relating to the marketing component of the restructuring charge recorded in fiscal 2001, resulting in a net credit to income of $89,000 for the quarter ended June 30, 2002.

At September 30, 2002, ATG had an accrued restructuring liability of $37.9 million, of which $28.8 million was long-term. The majority of the remaining liability is comprised of facility-related costs.

11. LITIGATION

On October 31, 2000, Aron Rosenberg, one of the Company s stockholders, brought a claim on ATG s behalf in the U.S. District Court for the District of Delaware. Mr. Rosenberg alleged that the Tudor and Raptor entities violated Section 16(b) of the Securities Exchange Act of 1934 in connection with their sale of ATG s common stock after its initial public offering on July 20, 1999. Those entities acquired the Company s common stock upon conversion of its Series D Preferred Stock that they acquired more than six months before the initial public offering. Mr. Rosenberg claimed that those entities should be deemed to have purchased the Company s common stock when the Company s stockholders approved an amendment to the Company s Certificate of Incorporation related to preferred stock of the Company on June 18, 1999. He also claimed that those entities obtained profits of more than $70 million in connection with sales of the Company s common stock within six months after June 18, 1999, and that those profits should be paid to the Company. In January 2002, the parties entered into a settlement agreement, later approved by the court, providing that Tudor would pay $1,050,000 to the Company and $400,000 to the plaintiff s attorneys, in return for which the Company would release Tudor from any claims under Section 16 of the Exchange Act arising from the facts and circumstances alleged in the complaint. On May 23, 2002 Tudor made the payment to the Company and this matter is now resolved. The receipt of the settlement of $1,050,000 has been recorded as contributed capital within additional paid in capital in the accompanying unaudited condensed consolidated balance sheet.

The Company and certain officers have been named defendants in seven purported class action suits currently pending in the United States District Court for the District of Massachusetts. Each of these cases alleges that the Company and certain officers have violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, which generally may subject issuers of securities and persons controlling those issuers to civil liabilities for fraudulent actions or defects in the public disclosure required by securities laws. Four of the cases were filed on various dates in October 2001 in the U.S. District Court for the District of Massachusetts. Three of the cases were initially filed in the Central District of California (the California actions) on various dates in August and September 2001. The California actions were consolidated and transferred to the District of Massachusetts on or about November 27, 2001. On December 13, 2001, the Court issued an Order of Consolidation in which it consolidated all actions filed against us and appointed certain individuals as Lead Plaintiffs in the consolidated action. It also appointed two law firms as Co-Lead Counsel, and a third law firm as Liaison Counsel. Counsel for the plaintiffs has filed a Consolidated Amended Complaint applicable to all of the consolidated actions. On April 19, 2002, the Company filed a motion to dismiss the case. The plaintiffs have filed their opposition to the motion, and the Company has submitted a response. While management believes the claims against the Company are without merit, and intends to defend the action vigorously, the litigation is in the preliminary stage.

A breach of contract claim was filed in Germany by DIFA Deutsche Immobilien Fonds AG against Art Technology Group GMBH, a subsidiary of the Company, on July 18, 2002. The suit alleges that ATG GmbH failed to pay rent on office space leased by the plaintiff and failed to deliver a bank guarantee, thereby breaching its lease obligations to plaintiff. ATG s defense to the suit is based, in part, on the plaintiff s failure to deliver the premises in habitable condition. A preliminary hearing on the matter is set for November 14, 2002. The plaintiff is seeking to recover approximately 1.4 million euros (approximately $1,403,920 as of November 7, 2002) plus 8% interest and the delivery of a security deposit in the form of a bank guarantee in the amount of approximately 675,000 euros (approximately $676,890 as of November 7, 2002). The amount that represents unpaid rent may change before the hearing, at the plaintiff s option, to account for any additional rents accruing prior to the hearing date. The prevailing party in a German lawsuit is also entitled to collect court costs and attorneys fees from the non-prevailing party according to a fee and cost schedule established by the court.

The Company is also subject to various other claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the Company s business, financial condition or results of operations.

12. RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Standards Accounting Board issued SFAS No. 141, *Business Combinations* (SFAS No. 141) and SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142) in July 2001. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. SFAS No. 142 requires that goodwill not be amortized but instead tested for impairment at least annually and more frequently upon the occurrence of certain events in accordance with the provisions of SFAS No. 142. Also under SFAS No. 142, intangible assets acquired in conjunction with a business combination are required to be separately recognized if the benefit of the intangible asset obtained is 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 with determinable lives will continue to be amortized over their respective useful lives. The adoption of SFAS No. 141 and SFAS No. 142 on January 1, 2002 did not have a material impact on the Company s financial position or results of operations.

During fiscal 2001, the Company determined that the remaining unamortized goodwill of $4.0 million associated with two professional services acquisitions was impaired, which was included as a component of the restructuring charge recorded in the fourth quarter of fiscal 2001 (see Note 10). The effect of no longer amortizing goodwill in accordance with SFAS 142 for the three and nine months ended September 30, 2001 is as follows:

	For the Three Months Ended September 30, 2001	**For the Nine Months Ended September 30, 2001**
Reported net loss	$ (9,029)	$ (63,821)
Add back: Goodwill amortization	337	2,105
Adjusted net loss	$ (8,692)	$ (61,716)
Basic and Diluted earnings per share:		
Reported net loss	$ (0.13)	$ (0.93)
Goodwill amortization	0.00	0.03
Adjusted net loss	$ (0.13)	$ (0.90)

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, but retains SFAS No. 121 s fundamental provisions for (a) recognition and measurement of impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. SFAS No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of a Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for segments of a business to be disposed of but retains the requirement to report discontinued operations separately from continuing operations and extends that reporting period to a component of an entity that either has been disposed of or is classified as held for sale. The Company adopted SFAS No. 144, effective January 1, 2002 which did not have a material impact on its financial position or results of operations.

In November 2001, the Emerging Issues Task Force (EITF) issued Topic No. D-103 relating to the accounting for reimbursements received for out-of-pocket expenses. In accordance with Topic No. D-103, reimbursements received for out-of-pocket expenses incurred should be characterized as revenue in the statement of operations. The Company has historically accounted for such reimbursements as a reduction of the cost of revenues. The Company adopted Topic No. D-103 effective January 1, 2002. Comparative condensed consolidated financial statements for prior periods have been reclassified to comply with the guidance in Topic No. D-103. The impact of the reclassification was to increase revenues by 2% and 1% in the three and nine months ended September 30, 2002, and by 1% for the three and nine months ended September 30, 2001, respectively.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (FAS 146), which addresses financial accounting and reporting for costs associated with exit or disposal activities. This Statement supercedes EITF 94-3 *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*, and establishes when a liability for a cost associated with an exit or disposal activity must be recognized, which is at the time the liability is incurred. Severance pay, in many cases, would be recognized over time rather than up front. If the benefit arrangement requires employees to render future service beyond a minimum retention period a liability should be recognized as employees render service over the future service period even if the benefit formula used to calculate an employee s termination benefit is based on length of service. The Company is required to adopt FAS 146 on December 31, 2002, and the impact is not expected to be material to its consolidated financial statements.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes appearing elsewhere in this report. This discussion and analysis contains forward looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward looking statements as a result of a number of factors, including those set forth below under Risk Factors that May Affect Results and elsewhere in this report.

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 products. We market and sell our products worldwide through our direct sales force, systems integrators, technology partners, resellers, 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 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 which is calculated as a certain percentage 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 on-line 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 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 currently maintain offices in Australia, Canada, England, France, Germany, Japan, the Netherlands, Sweden, and the United States. Revenues from customers outside the United States accounted for 30% and 39% of our total revenues for the three months ended September 30, 2002 and 2001, respectively and 30% and 35% of our total revenues for the nine months ended September 30, 2002 and 2001, respectively. In 2001, we began entering into sales contracts denominated in foreign currencies. On September 18, 2002, our Board of Directors formally approved our foreign currency hedging program to mitigate the risk of foreign currency fluctuations. As of September 30, 2002 there were no foreign currency hedging contracts outstanding.

Critical Accounting Judgments and Estimates

The management s discussion and analysis of financial condition and results of operations discusses our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates and judgments, the impairment of long-lived assets, provision for income taxes, valuation allowances for deferred taxes, and restructuring assumptions. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies most significantly affect the portrayal of our financial condition and require management s most difficult and subjective judgments.

REVENUE RECOGNITION

Not only is revenue recognition a key component of our results of operations, the timing of our revenue recognition also determines the timing of certain expenses, such as commissions. In measuring revenues, we follow the specific guidelines of SOP 97-2 and related authoritative literature, as discussed above. Certain judgments of management, however, affect the application of this policy. Revenue results are difficult to predict and any shortfall or delay in recognizing revenue could cause our operational results to vary significantly from quarter to quarter and could result in future operating losses. We maintain allowances for estimated losses resulting from the inability of our customers to make required payments. However, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required.

RESEARCH AND DEVELOPMENT COSTS

We account for research and development costs in accordance with SFAS No. 2, *Accounting for Research and Development Costs,* and SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* (SFAS No. 86), which specifies that costs incurred internally to develop computer software products should be charged to expense as incurred until technological feasibility is reached for the product. Once technological feasibility is reached, all software costs should be capitalized until the product is made available for general release to customers. Judgment is required in determining when technological feasibility is established. We believe that the time period from reaching technological feasibility until the time of general product release is very short. Costs incurred after technological feasibility is reached are not material, and accordingly, all such costs are charged to research and development expense as incurred.

RESTRUCTURING EXPENSE

We record restructuring charges in accordance with ETIF 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* and SAB 100, *(Restructuring and Impairment Charges).* These pronouncements require that we make estimates surrounding the amounts ultimately to be paid for actions that we have taken. At September 30, 2002, there are various accruals made for the costs to exit certain facilities and lease obligations, which may be adjusted periodically for either resolution of certain contractual commitments or changes in estimates of sub-lease income or the period of time the facilities will be vacant and sub-leased. In the quarter ended June 30, 2002, we recorded a net change increasing our restructured lease obligation accruals by $447,000 due to a change in sub-lease income and vacancy assumptions offset by favorable sub-lease transactions executed during the second quarter of 2002. This charge has been offset as a result of us receiving a refund of $536,000 related to the marketing component of the restructuring charge recorded in fiscal 2001, resulting in a net credit to income of $89,000 for the quarter ended June 30, 2002. Although we do not anticipate significant changes to our restructuring accruals, the actual costs may differ from that recorded in the event that the subleasing assumptions require adjustment due to changes in economic conditions surrounding the real estate market or we are successful in terminating our lease obligations prior to the scheduled termination date. Such changes could have a material impact on our operating results.

ACCOUNTING FOR INCOME TAXES

We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109 *Accounting for Income Taxes* (SFAS 109) which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. We evaluate quarterly the realizability of our deferred tax assets by assessing our valuation allowance and by adjusting the amount of such allowance, if necessary. At September 30, 2002 and December 31, 2001, our deferred tax asset was fully reserved. In addition, we have provided for potential amounts due in various foreign tax jurisdictions. Judgment is required in determining our worldwide income tax expense provision. In the ordinary course of global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of cost reimbursement arrangements among related entities. Although, we believe our estimates are reasonable, no assurance can be given that the final tax outcome of these matters will not be different than that which is reflected in our historical income tax provisions and accruals. Such differences could have a material impact on our income tax provision and operating results in the period in which such determination is made.

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		Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
REVENUES:				
Product licenses	48%	44%	48%	53%
Services	52	56	52	47
Total revenues	100	100	100	100
Total cost of revenues	38	38	38	39
Gross margin	62	62	62	61
OPERATING EXPENSES:				
Research and development	22	24	22	22
Sales and marketing	40	67	43	71
General and administrative	12	17	10	18
Stock-based compensation	1	1	1	1
Restructuring costs				41
Total operating expenses	75	109	76	153
LOSS FROM OPERATIONS	(13)	(47)	(14)	(92)
Interest and Other Income, Net	1	2	2	4
Net loss before benefit from income taxes	(12)	(45)	(11)	(88)
BENEFIT FROM INCOME TAXES		(15)		(30)
Net loss	(12)%	(30)%	(11)%	(58)%

The following table sets forth the cost of product license revenues as a percentage of product license revenues and the cost of services revenues as a percentage of services revenues:

	Three Months Ended		Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Cost of product license revenues	9%	8%	9%	6%

Cost of services revenues	64%	62%	64%	76%

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001

Revenues

Total revenues decreased 20% to $24.5 million for the three months ended September 30, 2002 from $30.5 million for the three months ended September 30, 2001. The decrease was primarily attributable to the slowing economy, reduced information technology spending and lengthening of the sales cycle. Revenues generated from international customers decreased to $7.5 million for the three months ended September 30, 2002 from $11.8 million for the three months ended September 30, 2001. For the three months ended September 30, 2002 one customer represented 10% to 15% of the our total revenues.

Total revenues decreased 30% to $77.0 million for the nine months ended September 30, 2002 from $109.2 million for the nine months ended September 30, 2001. The decrease was primarily attributable to the slowing economy, reduced information technology spending and lengthening of the sales cycle. Revenues generated from international customers decreased to $22.9 million for the nine months ended September 30, 2002 from $38.1 million for the nine months ended September 30, 2001.

We expect total revenues to decrease in 2002 as compared to 2001 and the trend of international revenues as a percentage of total revenues to be 25% to 28% through the remainder of 2002.

Product License Revenues

Product license revenues decreased 12% to $11.8 million for the three months ended September 30, 2002 from $13.4 million for the three months ended September 30, 2001. This decrease was primarily attributable to the slowing economy, reduced information technology spending and lengthening of the sales cycle. Product license revenues generated from international customers decreased to $4.2 million for the three months ended September 30, 2002 from $5.7 million for the three months ended September 30, 2001.

Product license revenues decreased 37% to $36.6 million for the nine months ended September 30, 2002 from $58.0 million for the nine months ended September 30, 2001. This decrease was primarily attributable to the slowing economy, reduced information technology spending and lengthening of the sales cycle. Product license revenues generated from international customers decreased to $12.1 million for the nine months ended September 30, 2002 from $21.8 million for the nine months ended September 30, 2001.

Product license revenues as a percentage of total revenues for the three months ended September 30, 2002 and 2001 were 48% and 44%, respectively, and for the nine months ended September 30, 2002 and 2001 were 48% and 53%, respectively. We expect product revenues as a percentage of total revenue to trend toward 50% for the remainder of 2002. We expect product license revenues to decrease in 2002 as compared to 2001.

Services Revenues

Services revenues decreased 26% to $12.7 million for the three months ended September 30, 2002 from $17.0 million for the three months ended September 30, 2001. The decrease was primarily attributable to the slowing economy and reduced information technology spending. Additionally, as a result of lower product sales, support and maintenance revenues and professional services revenues have decreased.

Services revenues decreased 21% to $40.4 million for the nine months ended September 30, 2002 from $51.3 million for the nine months ended September 30, 2001. The decrease was primarily attributable to the slowing economy and reduced information technology spending. Additionally, as a result of lower product sales, support and maintenance revenues and professional services revenues have decreased.

Services revenues as a percentage of total revenues for the three months ended September 30, 2002 and 2001 were 52% and 56%, respectively, and for the nine months ended September 30, 2002 and 2001 were 52% and 47%, respectively. We expect service revenues as a percentage of total revenues to trend toward 50% for the remainder of 2002.

Cost of Product License Revenues

Cost of license revenues was $1.1 million for both the three months ended September 30, 2002 and 2001, and was $3.2 million for both the nine months ended September 30, 2002 and 2001. The material components of cost of license revenues consist of the BroadVision settlement, compensation and benefit costs associated with sustaining engineering activities, and the software and maintenance costs associated with products that are embedded into current ATG 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 September 30, 2001 and 2002, we expensed $583,000, and for both the nine months ended September 30, 2002 and 2001, we expensed $1.75 million. We will pay the final quarterly installment of $500,000 in the three months ending December 31, 2002.

Our gross product margin decreased slightly to 91% for the three months ended September 30, 2002 from 92% for the three months ended September 30, 2001, and decreased slightly to 91% for the nine months ended September 30, 2002 from 94% for the nine months ended September 30, 2001 primarily due to lower license sales. For the remainder of 2002, we anticipate our gross product margin to remain consistent as compared to the three months ended September 30, 2002.

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 period to period 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 decreased 23% to $8.1 million for the three months ended September 30, 2002 from $10.5 million for the three months ended September 30, 2001. The decrease was primarily attributable to a reduction in our professional services workforce. Approximately 64% of the decrease was attributable to decreased compensation costs due to a reduction in our work force. The remaining 36% of the decrease was due to a decrease in operating expenses as a result of our restructuring efforts and cost containment initiatives.

Cost of services revenues decreased 33% to $25.9 million for the nine months ended September 30, 2002 from $38.9 million for the nine months ended September 30, 2001. The decrease was primarily attributable to a reduction in our professional services workforce. Approximately 50% of the decrease was attributable to decreased compensation costs due to a reduction in our work force. The remaining 50% of the decrease was due to a decrease in operating expenses as a result of our restructuring efforts and cost containment initiatives.

Our gross service margin decreased slightly to 36% for the three months ended September 30, 2002 from 38% for the three months ended September 30, 2001, and increased to 36% for the nine months ended September 30, 2002 from 24% for the nine months ended September 30, 2001 due to increased utilization percentages, decreases in third party contractors and our restructuring efforts. We anticipate gross service margins to trend toward 35% and 40% for the remainder of 2002.

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 decreased 25% to $5.4 million for the three months ended September 30, 2002 from $7.2 million for the three months ended September 30, 2001. The decrease was primarily attributable to reduction in our workforce. Approximately 68% of the decrease is related to decreased salaries and related benefits. The remaining 32% of the decrease was due to a decrease in operating expenses as a result of our restructuring efforts and cost containment initiatives.

Research and development expenses decreased 32% to $16.6 million for the nine months ended September 30, 2002 from $24.4 million for the nine months ended September 30, 2001. The decrease was primarily attributable to reduction in our workforce. Approximately 49% of the decrease is related to decreased salaries and related benefits. Approximately 22% of the decrease was due to a reduction in the use of third party contractors. The remaining 29% of the decrease was due to a decrease in operating expenses as a result of our restructuring efforts and cost containment initiatives.

Research and development expenses as a percentage of total revenues for the three months ended September 30, 2002 and 2001 were 22% and 24%, respectively, and for the nine months ended September 30, 2002 and 2001 were both 22%. We anticipate that research and development expenses as a percentage of total revenues will remain at our current levels through the remainder of 2002.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of salaries, commissions and other related benefits costs, travel, public relations, advertising, and marketing materials and events.

Sales and marketing expenses decreased 53% to $9.7 million for the three months ended September 30, 2002 from $20.5 million for the three months ended September 30, 2001. The decrease is primarily attributable to cost saving initiatives that resulted from a reduction of our sales and marketing group. Approximately 42% of the decrease was related to a decrease in compensation and benefit costs, and 22% of the decrease was related to a reduction in our marketing and promotional expenses. The remaining 36% was due to a decrease in operating expenses as a result of our restructuring efforts and cost containment initiatives.

Sales and marketing expenses decreased 57% to $33.3 million for the nine months ended September 30, 2002 from $77.3 million for the nine months ended September 30, 2001. The decrease is primarily attributable to cost saving initiatives that resulted in a reduction of our sales and marketing group. Approximately 39% of the decrease was related to a decrease in compensation and benefit costs, and 28% of the decrease was from a reduction in our marketing and promotional expenses. The remaining 23% was due to a decrease in operating expenses as a result of our restructuring efforts and cost containment initiatives.

Sales and marketing expenses as a percentage of total revenues for the three months ended September 30, 2002 and 2001 were 40% and 67%, respectively, and for the nine months ended September 30, 2002 and 2001 were 43% and 71%, respectively. We expect that sales and marketing expenses in 2002 will continue to decrease as a percentage of total revenues compared with 2001. However, sales and marketing expense can fluctuate as a percentage of total revenues depending on economic conditions, level and timing of global expansion, program spending, the rate at which new sales personnel become productive and the level of revenue growth.

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 decreased 43% to $3.0 million for the three months ended September 30, 2002 from $5.3 million for the three months ended September 30, 2001. Approximately 49% of the decrease was related to decreases in compensation and benefit costs as a result of headcount reductions through our restructuring efforts. The remaining 51% of the decrease was attributed to a decrease in recruiting, hiring, travel, training and direct office expenses.

General and administrative expenses decreased 62% to $7.8 million for the nine months ended September 30, 2002 from $20.4 million for the nine months ended September 30, 2001. Approximately 36% of the decrease was related to decreases in compensation and benefit costs, and 10% of the decrease was related to a reduction in our professional fees. Approximately 37% of the decrease was attributed to a decrease in recruiting, hiring, travel, training and direct office expenses. Approximately 24% of the decrease was in the provision for doubtful accounts for the nine months ended September 30, 2002.

General and administrative expenses as a percentage of total revenues for the three months ended September 30, 2002 and 2001 were 12% and 17%, and for the nine months ended September 30, 2002 and 2001 were 10% and 19%, respectively. We anticipate that general and administrative expenses will remain at our current levels for the remainder of 2002.

Restructuring

We undertook plans to restructure our operations during 2001 as a result of a global slowdown in information technology spending. Actions taken included consolidation of excess facilities, a worldwide workforce reduction, the write-off of certain unrealizable assets and settling certain obligations that had no future benefit. In the second quarter of 2001, we recorded a restructuring charge of $44.2 million, and in the fourth quarter of 2001, we recorded a restructuring charge of $32.7 million. Total restructuring charges for 2001 were $76.9 million.

The significant components of the restructuring charges are as follows (in thousands):

RESTRUCTURING CHARGES

	Twelve Months Ended December 31, 2001	Payments or Write-Offs in 2001	Accrued Restructuring Charges as of December 31, 2001	Payments in the Nine Months Ended September 30, 2002	Accrued Restructuring Charges as of September 30, 2002
Facilities-related costs	$ 60,918	$ 16,208	$ 44,710	$ 7,076	$ 37,634
Employee severance, benefits and related costs	7,938	6,748	1,190	920	270
Asset impairments	5,570	5,570			
Exchangeable share settlement	1,263	1,263			
Marketing costs	851	851			
Legal and accounting costs	405	232	173	173	
Total	$ 76,945	$ 30,872	$ 46,073	$ 8,169	$ 37,904

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, we estimated the vacancy period and sublease income. A component of the fourth quarter facility-related cost was a change in estimate of the second quarter facility-related restructuring charge. The net change in estimate was an additional charge of $1.5 million in the fourth quarter. Of the $1.5 million charge, a credit of $8.2 million was realized due to the termination buy-out of a certain lease included in the second quarter charge of $9.3 million, which is being paid ratably over 4.5 years. This credit was offset by an increase of approximately $9.7 million due to updated assumptions, as a result of a market analysis, indicating lower sublease rates and higher vacancy periods for two leases provided for in the second quarter. Included in the facility-related costs was the write-off of abandoned leasehold improvements and fixed assets of $7.7 million and $2.2 million, respectively. These fixed assets were directly related to the restructured excess office facilities.

The employee severance cost component of the restructuring charge was related to reductions in personnel. As part of the restructuring, we terminated the employment of 530 employees, or 46% of our workforce. Approximately 47% of these employees were from sales and marketing, 22% from services, 19% from general and administrative, and 12% from research and development.

The asset impairment costs included in the write-off of the remaining unamortized goodwill of approximately $4.0 million was related to two professional service acquisitions completed in 2000. In addition we determined that approximately $1.4 million of purchased software was impaired due to our revised product development strategy.

We settled 11,762 exchangeable shares with a certain employee. Upon settlement, we recorded $1.3 million as a charge to restructuring.

During the second quarter of 2002 we recorded a net change increasing the restructured lease obligation accruals by $447,000. We increased one lease obligation estimate by $1.3 million as a result of adjusting the estimated sublease income and vacancy assumptions due to the continued weakening of the real estate market in that location. Offsetting this addition, we recognized a benefit of $853,000 from two other restructured lease obligation accruals recorded due to favorable sublease transactions consummated during the current quarter. This net change has been offset by the receipt of a refund of $536,000 relating to the marketing component of the restructuring charge recorded in fiscal 2001. This refund, offset by the $447,000 in real estate changes, resulted in a net credit of $89,000 on the income statement for the current quarter ended June 30, 2002.

At September 30, 2002, we had an accrued restructuring liability of $37.9 million, of which $28.8 million was long-term. The majority of the remaining liability was comprised of facility-related costs.

At September 30, 2002, we had an accrued restructuring liability of $37.9 million, of which $28.8 million was long-te

Interest Income and Other, Net

Interest income decreased 69% to $299,000 for the three months ended September 30, 2002 from $973,000 for the three months ended September 30, 2001. The decrease was due to the overall decrease in the average balance of cash and cash equivalents and marketable securities available for investment, and the decline in interest rates for the three months ended September 30, 2002 compared to the three months ended September 30, 2001. Offsetting interest income was a loss from foreign currency exchange fluctuations and other income net of $222,000 for the three months ended September 30, 2002 which is an increase of 35% from $164,000 for the three months ended September 30, 2001. The net result was $77,000 for the three months ended September 30, 2002 compared to $809,000 for the three months ended September 30, 2001.

Interest income decreased 73% to $1.1 million for the nine months ended September 30, 2002 from $4.1 million for the nine months ended September 30, 2001. The decrease was due to the overall decrease in the average balance of cash and cash equivalents and marketable securities available for investment, and the decline in interest rates for the nine months ended September 30, 2002 from the nine months ended September 30, 2001. In addition, we experienced gains from foreign currency exchange fluctuations and other income of $724,000 for the nine months ended September 30, 2002 compared to $100,000 for the nine months ended September 30, 2001. The majority of the increase was a result of the weakening dollar that occurred during the second quarter of 2002.

Benefit for Income Taxes, Net Operating Losses and Tax Credit Carryforwards

For the three and nine months ended September 30, 2002 we incurred net operating losses. Due to the uncertainty surrounding the utilization of our net deferred tax assets, net operating losses and research credits carryforwards, we have recorded a 100% valuation allowance against any income tax benefits generated for the period. For the three and nine months ended September 30, 2001, we recognized a tax benefit of $4.7 million and $32.3 million, respectively.

As of December 31, 2001, we had net operating loss carryforwards of approximately $124.1 million for federal income tax purposes and approximately $120.1 million for state income tax purposes. Approximately $35.0 million of the federal and state income tax net operating loss carryforwards relate to the exercise of incentive and nonqualified stock options which are treated as compensation deductions for federal tax credit carryforwards of approximately $1.0 million. If not utilized, these carryforwards will expire at various dates beginning 2011 through 2021. If substantial changes in our ownership should occur, as defined by Section 382 of the Internal Revenue Code, there could be annual limitations on the amount of carryforwards that can be realized in future periods. We have completed several refinancings since our inception and have incurred ownership changes, as defined under the Internal Revenue Code, which could have an impact on our ability to utilize these tax credit and operating loss carryforwards.

As of December 31, 2001, we had recorded a full valuation-allowance against its deferred tax assets due to the uncertainty surrounding the reliability of these assets. In order to record the full valuation against the previously recognized tax assets, we recorded a realized charge of $23.9 million in the fourth quarter of 2001.

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 and commercial credit facilities. In 2000 we funded our cash requirements in part from operations. At September 30, 2002, we had $47.0 million in cash and cash equivalents and $20.8 million in marketable securities, and $4.6 million in restricted cash.

Cash provided by operating activities was $2.1 million for the nine months ended September 30, 2002. This represents an operating loss of $8.7 million. Changes in working capital items consist primarily of $9.7 million in cash used for accrued expenses, and deferred revenues. An additional $8.2 million in cash was used relating to the restructuring accruals. Restricted cash also declined by $12.2 million due to us being able to secure $11.3 million of our outstanding LC s under our line of credit. Our line of credit at December 31, 2001 did not allow for this type of collateralization option. Additionally, $882,000 of the outstanding LC s at December 31, 2001 expired during the nine months ended September 30, 2002. This was partially offset from collections of accounts receivable of $10.1 million and non-cash depreciation of $5.4 million.

Net cash used in investing activities was $4.5 million. Our investing activities consisted primarily of net purchases of marketable securities of $6.8 million for the nine months ended September 30, 2002. Our capital expenditures for the nine months ended September 30, 2002 were approximately $843,000. Management expects that capital expenditures will total approximately $300,000 to $500,000 for the remaining months of 2002. The decrease from 2001 is due to reduced capital infrastructure requirements.

Net cash provided by financing activities was $1.1 million for the nine months ended September 30, 2002, principally representing proceeds from stock option exercises and employee stock purchase plan of $1.5 million, offset by our long-term obligation payments made to Broadvision of $1.5 million. Net cash provided by financing activities also included a $1,050,000 settlement payment from the Tudor entity in relation to the suit brought by Aron Rosenberg on our behalf on October 31, 2000. See Part II. Item 1, Legal Proceedings for further details.

Effective June 13, 2002, we entered into a $15 million revolving line of credit with the bank which provides for borrowings of up to the lesser of $15 million or 80% of eligible accounts receivable. The line of credit bears interest at the bank's prime rate (4.75% at September 30, 2002). As of September 30, 2002, approximately $534,000 was available for future borrowings. The line of credit is secured by all of our tangible and intangible intellectual and personal property and is subject to financial covenants including liquidity coverage and profitablity. Effective September 27, 2002 the revolving line of credit was modified to, among other things, increase the amount of the allowable quarterly net loss for the quarter ended September 30, 2002 from $3 million to $4.5 million. As of September 30, 2002, we were in compliance with all related financial covenants. While there were no outstanding borrowings under the facility at September 30, 2002, we have issued letters of credit (LC's) totaling $12.2 million, which are supported by this facility. During the term of the credit facility, we are no longer required to fully cash secure all of our LC's. However, we are required to maintain $18 million of unrestricted cash with the bank at all times during the term of the line of credit. As a result of this requirement, this revolving line of credit does not increase the amount of net cash available to us during the term of the agreement. The revolving line of credit expires on December 27, 2002. In the event that we do not comply with any of the covenants within the line of credit or default on any of our provisions, the bank's significant remedies include, 1) declaring all obligations immediately due and payable; 2) ceasing to advance money or extend credit for our benefit, and; 3) apply to the obligations any balances and deposits held by us or any amount held by the bank owing to or for the credit or the account of us. If the agreement expires, or is not extended, the bank will require outstanding LC's at that time to be cash secured on terms acceptable to the bank.

As of September 30, 2002, we had commitments totaling approximately $15,875,000 in the form of outstanding LC s in favor of our various landlords to secure obligations under our facility leases. As of September 30, 2002, $4,604,000 of the LC s were cash collateralized. At December 31, 2001, we had commitments totaling approximately $16,757,000 of outstanding LC's in favor of our various landlords to secure obligations under our facility leases. All of these LC's were fully cash collateralized as of December 31, 2001.

At September 30, 2002, our contractual cash obligations were as follows (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**
Lease Commitments	$ 94,944	$ 4,186	$ 48,401	$ 23,613	$ 18,744
BroadVision Settlement	$ 500	$ 500			

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

Risk Factors That May Affect Results

This quarterly report contains forward looking statements, including statements about our growth and future operating results. For this purpose, any statement that is not a statement of historical fact should be considered a forward-looking statement. We often use the words believes, anticipates, plans, expects, intends and similar expressions to help identify forward-looking statements.

There are a number of important factors that could cause our actual results to differ materially from those indicated or implied by forward-looking statements. Factors that could cause or contribute to such differences include those discussed below, as well as those discussed elsewhere in this quarterly report.

RISKS RELATED TO OUR BUSINESS

We may not be able to sustain or increase our revenue or profitability on a quarterly or annual basis.

We incurred a loss in each quarter of fiscal 2001 and the first three quarters of 2002. As of September 30, 2002, we had an accumulated deficit of $179.0 million. Although our revenues have grown significantly in the past, they have grown from a relatively small base and, as a result, we do not believe that we will be able to sustain these growth rates. In addition, we believe the current worldwide 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, and operate in a rapidly evolving industry, 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 achieve 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:

- fluctuating economic conditions, particularly as they affect our customers willingness to expand information technology spending;
- the timing of sales of our products and services;
- the timing of customer orders and product implementations;
- delays in introducing new products and services;

- increased expenses, whether related to sales and marketing, product development or administration;
- 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 should not be relied upon as an indication of our future performance.

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 worldwide has increased the average length of our sales cycle as customers have deferred implementing new e-commerce or customer relationship management 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 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. 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, and the Netscape/Sun Microsystems Alliance, among others. In addition, we compete with portal software vendors such as Epicentric, SAP Portals, a subsidiary of SAP, and Plumtree. 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 use 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 relationships 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.

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 are unable to attract and retain other key personnel.

Our success depends largely on the skills, experience and performance of key members of our management and other key personnel. If we lose one or more of our key employees, our business could be harmed. 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 could incur substantial costs protecting our intellectual property from infringement or defending against a claim of infringement.

Our professional 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 other parties from using our intellectual property without our 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 $14.5 million had been paid as of September 30, 2002.

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; or
- refund the license fees paid to us for the infringing product.

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 new or enhanced 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 currently maintain offices in Australia, Canada, England, France, Germany, Japan, the Netherlands, and Sweden. We derived 30% of our total revenues from customers outside the United States for the nine months ending September 30, 2002. We anticipate that revenues from customers outside the United States could 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:

- 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 systems 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; 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 ATG 5.6 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. Despite internal testing and testing by customers, these products, as well as our existing 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 approximately $1.2 million and Toronto Technology Group Inc. in July 2000 for approximately $12.0 million. These acquisitions did not produce the revenues and synergies we expected. We incurred approximately $5.3 million in restructuring charges during the year ended December 31, 2001 related to the write off of unamortized goodwill and the settlement of restricted stock in connection with these acquisitions. In addition, we incurred additional restructuring charges during the year ended December 31, 2001 in reducing headcount related to the Toronto Technology Group Inc. acquisition.

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 expenses in integrating the operations and personnel of the acquired company into our operations 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. 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 continued use of the Internet for e-commerce. The current worldwide economic downturn has reduced demand for our products as customers and potential customers delay or cancel the implementation of customer relationship management solutions. If the market for our products and services does not continue to mature, we will be unable to execute successfully our business plan. Adoption of electronic commerce and customer relationship management, particularly by those companies that have historically relied upon traditional means of commerce, will require a broad acceptance of different methods of conducting business. Our future revenues and profits will substantially depend on the Internet being accepted and widely used for commerce and communication. If Internet commerce does not continue to grow or grows more slowly than expected, our future revenues and profits may not meet our expectations or those of analysts. Similarly, purchasers with established patterns of commerce may be reluctant to alter those patterns or may otherwise resist providing the personal data necessary to support our consumer profiling capability.

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 that 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 ATG 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. ATG 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.

RISKS RELATED TO THE SECURITIES MARKETS

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 $.58 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.

We currently are the subject of securities class action litigation. If a court awards damages to the plaintiffs, the total amount could exceed the limit of our existing insurance. This litigation also may divert management s attention and resources. We may be the target of similar litigation in the future if the market for our stock becomes volatile. For a further description of the pending litigation, see Item 1. Legal Proceedings in Part II of this quarterly report.

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 15% of our common stock as of September 30, 2002. 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;

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; and

authorizing anti-takeover provisions.

In addition, we adopted a shareholder rights plan in 2001 and Delaware law may further discourage, delay or prevent someone from acquiring or merging with us.

24

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 nine months ended September 30, 2002. We have not used derivative financial instruments to hedge foreign currency exposures or for speculative 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.

Item 4. Controls and Procedures

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934) as of a date within 90 days of the filing date of this quarterly report, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and are operating in an effective manner.

CHANGES IN INTERNAL CONTROLS

There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On October 31, 2000, Aron Rosenberg, one of our stockholders, brought a claim on our behalf in the U.S. District Court for the District of Delaware. Mr. Rosenberg alleged that the Tudor and Raptor entities violated Section 16(b) of the Securities Exchange Act of 1934 in connection with their sale of our common stock after our initial public offering on July 20, 1999. Those entities acquired our common stock upon conversion of our Series D preferred stock that they acquired more than six months before the initial public offering. Mr. Rosenberg claimed that those entities should be deemed to have purchased our common stock when our stockholders approved an amendment to our certificate of incorporation related to our preferred stock on June 18, 1999. He also claimed that those entities obtained profits of more than $70 million in connection with sales of our common stock within six months after June 18, 1999, and that those profits should be paid to us. In January 2002, the parties entered into a settlement agreement that was subsequently approved by the court. The settlement provided that Tudor would pay $1,050,000 to us and $400,000 to the plaintiff s attorneys, in return for which we would release Tudor from any claims under Section 16 of the Securities Exchange Act arising from the facts and circumstances alleged in the complaint. On May 23, 2002 Tudor made the payment to us and this matter is now closed.

We and certain officers have been named defendants in seven purported class action suits currently pending in the United States District Court for the District of Massachusetts. Each of these cases alleges that we and the named officers have violated Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5, which generally may subject issuers of securities and persons controlling those issuers to civil liabilities for fraudulent actions or defects in the public disclosure required by securities laws. Four of the cases were filed on various dates in October 2001 in the U.S. District Court for the District of Massachusetts. Three of the cases were initially filed in the Central District of California on various dates in August and September 2001. These three California actions were consolidated and transferred to the District of Massachusetts on or about November 27, 2001. On December 13, 2001, the Court issued an Order of Consolidation in which it consolidated all actions filed against us and appointed certain individuals as lead plaintiffs in the consolidated action. It also appointed two law firms as co-lead counsel, and a third law firm as liaison counsel. Counsel for the plaintiffs has filed a Consolidated Amended Complaint applicable to all of the consolidated actions. On April 19, 2002 we filed a motion to dismiss the case. The plaintiffs have filed their opposition to the motion, and we have submitted a response. While management believes the claims against us are without merit and intends to defend the action vigorously, the litigation is in the preliminary stage.

A breach of contract claim was filed in Germany by DIFA Deutsche Immobilien Fonds AG against Art Technology Group GMBH, a subsidiary of the Company, on July 18, 2002. The suit alleges that ATG GmbH failed to pay rent on office space leased by the plaintiff and failed to deliver a bank guarantee, thereby breaching its lease obligations to plaintiff. ATG s defense to the suit is based, in part, on the plaintiff s failure to deliver the premises in habitable condition. A preliminary hearing on the matter is set for November 14, 2002. The plaintiff is seeking to recover approximately 1.4 million euros (approximately $1,403,920 as of November 7, 2002) plus 8% interest and the delivery of a security deposit in the form of a bank guarantee in the amount of approximately 675,000 euros (approximately $676,890 as of November 7, 2002). The amount that represents unpaid rent may change before the hearing, at the plaintiff s option, to account for any additional rents accruing prior to the hearing date. The prevailing party in a German lawsuit is also entitled to collect court costs and attorneys fees from the non-prevailing party according to a fee and cost schedule established by the court.

We are subject to various other claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on our business, financial condition or results of operations.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1 First Loan Modification Agreement between the Registrant and Silicon Valley Bank dated September 30, 2002.

10.2 Amendment Agreement between the Registrant and Silicon Valley Bank dated October 4, 2002.

(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 November 14, 2002.

ART TECHNOLOGY GROUP, INC.
(Registrant)

By:	/s/ Edward Terino Edward Terino Senior Vice President and Chief Financial Officer (Chief Financial and Accounting Officer)

CERTIFICATIONS

I, Paul G. Shorthose, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Art Technology Group, Inc.;

2. based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of Art Technology Group, Inc. as of, and for, the periods presented in this quarterly report;

4. Edward Terino, the Senior Vice President, Finance and Chief Financial Officer of Art Technology Group, Inc., and I:

are responsible for establishing and maintaining disclosure controls and procedures (as defined for purposes of Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended) for Art Technology Group, Inc.;

have designed such disclosure controls and procedures to ensure that material information relating to Art Technology Group, Inc., included its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report was prepared;

have evaluated the effectiveness of the disclosure controls and procedures of Art Technology Group, Inc. as of a date within 90 days prior to the filing date of this quarterly report; and

have presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on the required evaluation as of that date;

5. Mr. Terino and I have disclosed to the auditors of Art Technology Group, Inc. and to the audit committee of the board of directors of Art Technology Group, Inc.:

all significant deficiencies in the design or operation of internal controls that could adversely affect the ability of Art Technology Group, Inc. to record, process, summarize and report financial data and have identified for such auditors any material weaknesses in internal controls; and any fraud, whether or not material, that involves management or other employees who have a significant role in the internal controls of Art Technology Group, Inc.; and

6. Mr. Terino and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Paul G. Shorthose
Paul G. Shorthose
President and Chief Executive Officer
(principal executive officer)

I, Edward Terino, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Art Technology Group, Inc.;

2. based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of Art Technology Group, Inc. as of, and for, the periods presented in this quarterly report;

4. Paul G. Shorthose, the President and Chief Executive Officer of Art Technology Group, Inc., and I:

are responsible for establishing and maintaining disclosure controls and procedures (as defined for purposes of Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended) for Art Technology Group, Inc.;

have designed such disclosure controls and procedures to ensure that material information relating to Art Technology Group, Inc., including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report was prepared;

have evaluated the effectiveness of the disclosure controls and procedures of Art Technology Group, Inc. as of a date within 90 days prior to the filing date of this quarterly report; and

have presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on the required evaluation as of that date;

5. Mr. Shorthose and I have disclosed to the auditors of Art Technology Group, Inc. and to the audit committee of the board of directors of Art Technology Group, Inc.:

all significant deficiencies in the design or operation of internal controls that could adversely affect the ability of Art Technology Group, Inc. to record, process, summarize and report financial data and have identified for such auditors any material weaknesses in internal controls; and

any fraud, whether or not material, that involves management or other employees who have a significant role in the internal controls of Art Technology Group, Inc.; and

6. Mr. Shorthose and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Edward Terino
Edward Terino
Senior Vice President, Finance and Chief Financial Officer
(principal financial and accounting officer)