

ART TECHNOLOGY GROUP INC

Form 10-K

March 17, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**Form 10-K**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2007**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from        to**

**Commission file number 000-26679**

**Art Technology Group, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**04-3141918**

*(I.R.S. Employer Identification No.)*

**One Main Street**

**Cambridge, Massachusetts**

*(Address of principal executive offices)*

**02142**

*(Zip Code)*

**(617) 386-1000**

*(Registrant's telephone number, including area code)*

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

**Title of Each Class**

**Name of Each Exchange on Which Registered**

**Common Stock, \$0.01 par value with Associated Preferred Stock Purchase Rights**

**The Nasdaq Stock Market, LLC**

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

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As June 30, 2007 (the last business day of the registrant's most recently completed second fiscal quarter), the aggregate market value of voting stock held by non-affiliates of the registrant was approximately \$338,216,845.

As of March 10, 2008, the number of shares of the registrant's common stock outstanding was 129,642,923.

#### **Documents Incorporated by Reference**

Portions of the registrant's definitive proxy statement for its annual meeting of stockholders to be held on May 22, 2008 are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III.

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**ART TECHNOLOGY GROUP, INC.**

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References in this Report to we , us , our and ATG refer to Art Technology Group, Inc. and its subsidiaries. ATG and Art Technology Group are our registered trademarks, and ATG Wisdom is our trademark. This Report also includes trademarks and trade names of other companies.

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**PART I**

*Some of the information contained in this Report consists of forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Use of words such as believes, expects, anticipates, intends, plans, estimates, should, likely or similar expressions indicate a forward-looking statement. These statements are subject to risks and uncertainties and are based on the beliefs and assumptions of our management based on information currently available to our management. Important factors that could cause actual results to differ materially from the forward-looking statements include, but are not limited to, those set forth below under the heading Risk Factors. We assume no obligation to update any forward-looking statements.*

**Item 1. Business**

**Our Business**

We develop and market a comprehensive suite of e-commerce software products and software-as-a-service ( SaaS ) solutions as well as provide related services, including support and maintenance, professional services, application hosting, eStara e-commerce optimization services solutions for enhancing online sales, and education. Our customers use our products and services to power their e-commerce websites, attract prospects, convert sales, and offer ongoing customer care services. Our solutions are designed to provide a scalable, reliable and sophisticated e-commerce website for our customers to create a satisfied, loyal and profitable online customer base.

**Corporate Information**

We were incorporated in 1991 in the Commonwealth of Massachusetts and in 1997 in the State of Delaware, and have been a publicly traded corporation since 1999. Our corporate headquarters are at One Main Street, Cambridge, Massachusetts 02142. We have domestic offices in Chicago, Illinois; New York, New York; Washington D.C.; Reston, Virginia; San Francisco, California; and Seattle, Washington; and international offices in Canada; France; Northern Ireland; Singapore; and the United Kingdom. As of December 31, 2007, we had a total of 442 employees and we have more than 900 customers. Our Internet web site address is [www.atg.com](http://www.atg.com).

**Overview**

We provide software and services that help online businesses increase their revenues. We seek to differentiate ourselves by enabling businesses to use our solutions to provide a richer, more personalized and more compelling online shopping experience. We provide merchandisers and marketers more control over the online channel, and enable customer service agents to provide consumers more consistent, personalized and relevant assistance. Our solutions deliver better consistency and relevancy by capturing and maintaining information about customers personal preferences, online activity, and transaction history, and by using this information to deliver more personalized and contextual content.

We offer our products and services under two brands; our ATG e-commerce platform solutions and eStara e-commerce optimization services. Our ATG e-commerce platform solutions are delivered through perpetual software licenses and managed application hosting services offerings. Our eStara e-commerce optimization services are site-independent solutions, meaning that they are interoperable with any e-commerce platform, and are delivered as recurring SaaS. Our eStara e-commerce optimization services include Click-to-Call, Click-to-Chat and Call Tracking services. On February 5, 2008 we acquired eShopperTools.com, Inc., also known as CleverSet, and will begin offering CleverSet s personalization and recommendation services in early 2008, under the eStara brand.

We market our products and services primarily to Global 2000 companies and other businesses that have large numbers of online users and utilize the Internet as an important business channel. We focus primarily on providing our software and services to businesses in the retail, consumer products, manufacturing, media and entertainment, telecommunications, financial services, travel and insurance industries. We have over 900 customers, including Amazon, American Eagle Outfitters, American Express, AOL, AT&T, Best Buy, B&Q, Cabela's, Carrefour, Cingular, Coca Cola, Continental Airlines, Dell, DirecTV, El Corte Ingles, Expedia, France Telecom, Harvard Business School Publishing, Hewlett-Packard, Intuit, Hilton, HSBC, L.L Bean, Macy's, Meredith, Microsoft,

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Neiman Marcus, New York & Company, Nokia, OfficeMax, Overstock.com, PayPal, Philips, Procter & Gamble, Sears, Sony, Symantec, T Mobile, Target, Urban Outfitters, Verizon, Viacom, Vodafone and Walgreens.

Our business has evolved significantly since our incorporation in 1991:

Until 1995, we functioned primarily as a professional services organization in the Internet commerce market.

In 1996, we began offering Internet commerce and software solutions, initially focusing on infrastructure products.

In 2004, we began to concentrate on developing application products, having concluded that the market for infrastructure products had become increasingly standards driven and that we could best differentiate ourselves by offering our clients advanced applications functionality.

In November 2004, we acquired Primus Knowledge Solutions, Inc. ( Primus ), a provider of software solutions for customer service designed to help companies deliver a superior customer experience via contact centers, e-mail and web self-service. The Primus solution extended our offerings beyond commerce and marketing and into customer service.

In 2004, we also began to offer our clients hosted SaaS services as an alternative delivery model for our application solutions. We believe that hosted services can provide significant advantages for our clients, and provide us with a substantial opportunity for growth.

In 2005, we completed the integration of Primus applications into the ATG platform.

In October 2006, we acquired eStara, Inc. ( eStara ), a provider of e-commerce optimization service solutions for enhancing online sales and support initiatives. The eStara solutions provided us with a new channel to help our clients convert web browsing activities into sales, as well as business opportunities independent of ATG-powered websites.

In 2007, we initiated a strategy to sell site-independent OnDemand services to enable our customers to increase on-line sales. One result of this strategy is that we will recognize revenue from more of our transactions on a ratable basis. This increase in ratably recognized revenue should allow for more predictable revenue and earnings in future periods.

In February 2008, we acquired CleverSet, a provider of automated personalization engines, used to optimize e-commerce experiences by presenting visitors with relevant recommendations and information. CleverSet s next-generation technology has been shown to significantly lift e-commerce revenue by increasing conversion rates and order size. We will offer these services under our eStara brand.

Online retailers periodically upgrade or replace the network and enterprise applications software and the related hardware systems that they use to run their e-commerce operations in order to take advantage of advances in computing power, system architectures and enterprise software functionality that enable them to increase the capabilities of their e-commerce systems while simplifying operation and maintenance of these systems and reducing their cost of ownership. We refer to these major system upgrades or replacements as replatforming.

We believe that a company s replatforming is a significant event that often leads to a sale of a e-commerce software license. We believe that on average, customers in our market replatform or refresh their e-commerce software approximately every five years. We currently believe that we are in a period of increased corporate spending on



e-commerce solutions across many of our sectors.

**Our Strategy**

Our objective is to be the industry leader in helping businesses do more business on the Internet. We intend to achieve this objective by implementing the following key components of our strategy:

*Deliver a commerce platform with leadership functionality, suitable for the most demanding enterprises.* Our clients tell us that, in some cases, our platform handles over 100,000 orders per day in peak periods. Leading industry analysts rank our overall offering number one among commerce platforms for

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business-to-consumer sites on criteria, including reliability and scalability, administration and management, catalog/content management, campaign management and customer self-service. It is our objective to continue to provide leadership in e-commerce functionality and operational excellence.

*Through our eStara e-commerce optimization services brand, deliver solutions independent of the choice of web platform.* Our eStara e-commerce optimization service solutions can be delivered to clients on a site-independent basis on any e-commerce platform, or custom-built websites, across all industries. This increases the size of our market opportunity and customer penetration.

*Through managed application hosting services, provide the same quality platform to mid-tier companies and others who opt to outsource their e-commerce operations.* By leveraging our experience with the pre-built OnDemand offerings, our Professional Services organization assists our clients with their ATG implementations, thus helping our clients quickly and economically launch their e-commerce and service projects.

*Differentiate by providing a more personalized, more relevant, more consistent shopping experience.* We give merchandisers and marketers the power and analytics to define offers and cross-sells, to follow up on abandoned shopping carts, to perform A/B split tests and to create multi-channel, multi-stage web and e-mail campaigns that match a company's selling strategy with information about a visitor's browsing behavior, purchase and interaction history, preferences and profile. This increases basket size and the number of website visitors who go on to purchase items from that website, resulting in increased revenue. We use this same information to extend the consistent customer experience to the customer service agent in the call center, which can result in a more satisfied, loyal and profitable customer.

*Leverage existing sales channels.* We sell our products primarily through our direct sales organization. In addition, a significant portion of our product revenue is co-sold or influenced by a variety of business partners, including systems integrators, solution providers and other technology partners. We currently have a broad range of business alliances throughout the world, with companies such as Accenture, Capgemini, Deloitte Consulting, Sapient, Tata Consulting Services and Wipro as well as regional integrators and interactive agencies such as aQuantive, BlastRadius, imc<sup>2</sup>, CGI, LBi Group, McFadyen Consulting, Professional Access, Resource Interactive and D2C2. In most geographies and situations, our goal is both to maintain close relationships directly with our clients while also motivating systems integrators and other channel partners to implement our applications in their projects and solution sets.

*Leverage and expand our service capabilities.* We have extensive experience in web application development and integration services, as well as knowledge management design and call-center systems deployment. Through our Professional and Education Services organizations, we provide services to train our systems integrators, value added resellers and complementary software vendors in the use of our products and offer consulting services to assist with customer implementations. We seek to motivate our business partners to provide joint implementation services to our end user customers. We intend to continue to seek additional opportunities to increase revenues from product sales by expanding our base of business partners trained in the implementation and application of our products.

*International expansion.* We have seen an increase in sales and pipeline growth in Europe and India. We seek to invest resources into further developing our reach internationally. In support of this initiative we have entered into partnership agreements abroad that will support our continued growth. As the international market opportunity continues to develop we will adjust our strategy.

## **ATG Licensed Software Products**

We provide a comprehensive e-commerce product suite designed to enable our clients to attract visitors, convert them to buyers, deliver customer service and analyze the results. The products that comprise our comprehensive e-commerce product suite are as follows:

*ATG Commerce* is a comprehensive, highly scalable e-commerce platform. Its flexible, component-based architecture enables our clients to personalize the online buying experience for their customers, so that customers can more easily find desired products, comparison shop, register for gifts, pre-order products, redeem coupons and execute other useful features. *ATG Commerce*'s functionality includes catalogs, product

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management, shopping carts, checkout, pricing management, merchandising, promotions, inventory management and business-to-business order management.

*The ATG Adaptive Scenario Engine* is a platform that provides the enabling technology and core functionality to allow our clients to develop and manage robust, adaptable, scalable and personalized e-commerce applications across channels and through the complete customer lifecycle. The ATG platform is designed to allow our clients to easily integrate these applications across their marketing/merchandising, e-commerce and customer care organizations.

*ATG Commerce Search* is a dynamic, integrated search solution that incorporates natural language technology into our clients' online storefronts. ATG Commerce Search is designed to enable shoppers to navigate our clients' e-commerce sites quickly and efficiently to find merchandise they want and discover new items, as well as make purchases directly from the search results page.

*ATG Merchandising* enables our clients' merchandising professionals to directly manage their online storefronts including catalogs, products, search facets, promotions, pricing, coupons and special offers to help quickly connect shoppers with the items most likely to interest them.

*ATG Content Administration* is a comprehensive web content management solution to support personalized websites throughout the entire content process, including creation, version tracking, preview, editing, revision, approval and site deployment.

*ATG Outreach* is an e-marketing solution that leverages customer information gained through web interactions, preferences and behaviors to enable our clients to create relevant, personalized outbound marketing and service campaigns.

*ATG Self-Service* offers consumers access to personalized answers to questions and helps the customer answer his or her questions without telephoning for help. ATG Self-Service combines an answer repository with multi-lingual natural language search and navigation capabilities. The application also offers comprehensive business reporting that helps clients better understand customers' needs and preferences.

*ATG Commerce Service Center* provides complete e-commerce support for call center agents to create and manage orders in a unified browser based application for the web and call-center environments.

*ATG Knowledge* is a knowledge management solution that call center agents who provide customers with assisted service can use to find the answers to customer inquiries and resolve problems. ATG Knowledge enables our clients' agents to fulfill a wide range of customer needs by unifying customer management, knowledge management and incident management into a single solution.

*ATG Campaign Optimizer* assists marketing professionals in defining comparative tests of different offers, promotions and product representations through an A/B split testing solution. The product puts those tests into production, specifying the segments of website visitors to be tested, and finally writes reports on the test results. Methods for testing campaigns provided by our competitors often require programming by expert developers, and sometimes even involve network infrastructure modifications. ATG Campaign Optimizer is designed to allow non-technical marketing professionals to create and execute comparative tests that can be used to increase the effectiveness of online marketing activities without the need for expert programming or infrastructure modifications.

*ATG Customer Intelligence* is an integrated set of datamart and reporting capabilities to monitor and analyze commerce and customer care performance. It is designed to combine key data from the ATG product suite, such as purchases, searches, escalations and click-throughs, with behavioral data from web traffic analysis and demographic

data, such as age, gender and geography.

Our products allow companies to present a single view of themselves to their customers through our repository integration. This integration technology is designed to allow companies to easily access and utilize data in the enterprise regardless of the data storage format or location. The data can be leveraged in native form without having to move, duplicate or convert the data. By enabling these capabilities in a cost-effective manner, we believe our

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products can help companies protect their brands and keep their customers from becoming confused or frustrated, all of which positively impact customer satisfaction and loyalty.

We support the adoption of open application server infrastructure by our existing and new clients and work closely with other application server, operating system and database vendors to increase the value customers receive from our products on a variety of popular infrastructure components.

## **Recurring Revenue**

We deliver OnDemand Services that generate recurring revenue under both of our brands. Under the eStara brand, we offer site-independent solutions which we call eStara e-commerce optimization services. These solutions are designed to increase conversion rates and increase basket size for our customers. We also offer managed application hosting services under our ATG e-Commerce brand

### ***eStara e-Commerce Optimization Services Offerings***

eStara e-Commerce optimization services are hosted on our servers and are platform and site-independent so a client can benefit from eStara's e-commerce optimization services whether it elects to run its online environment on an ATG-powered e-commerce platform, another e-commerce platform or a custom built website.

*eStara Click to Call* is designed to allow online prospects and customers to transition seamlessly within the context of their online session into immediate telephone or PC-based voice contact with businesses. Web site visitors, e-mail recipients or viewers of a banner ad simply click a Click to Call button and select PC-to-phone or phone-to-phone to connect in real-time with our clients' sales or customer service agents.

*eStara Click to Chat* allows online prospects and customers to initiate a text chat session online with our clients' sales or customer service agents by simply clicking a Click to Chat button.

*eStara Call Tracking* is designed to allow our clients to accurately track every inbound telephone response to their print and online promotional campaigns.

*eStara Recommendations (formerly CleverSet)* is an automated personalized recommendation engine, used to optimize e-commerce experiences by presenting visitors with relevant recommendations and information. This next-generation technology has been shown to significantly lift e-commerce revenue by increasing conversion rates and order size.

### ***ATG OnDemand***

For clients that do not wish to expend resources on running e-commerce applications in-house, we offer managed application hosting services for the full spectrum of ATG software applications, which we call ATG OnDemand. Under this model, clients can purchase licenses to our software or receive the software as a service paying a monthly subscription fee, and then we host the solutions in our hosted environment and provide all additional software, hardware, network and full technical operational and support services. These services include the provisioning, management and monitoring of the application infrastructure including bandwidth, network, security, servers, operating systems, enabling software and ATG applications. We support our ATG OnDemand clients on a 24/7 basis and provide problem resolution services, application change management services, and service level agreements related to application availability.

There are several advantages for organizations to choose an ATG OnDemand managed services model, which makes this a potential growth area for us. These include:

leveraging our experience to accelerate growth of the client's online business and allowing clients to focus on their core competencies;

shifting the client's technology risks to us;

shortening the time to market (vs. in-house development, deployment and maintenance); and

avoiding upfront and ongoing expenditures required to purchase and maintain software and hardware.

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### ***Customer Support and Maintenance Services***

We offer four levels of customer support and maintenance including our Premium Support Program, which consists of access to technical support engineers 24/7, for customers deploying mission critical applications. For an annual support and maintenance fee, customers are entitled to receive software upgrades and updates, maintenance releases, online documentation and eServices including bug reports and unlimited technical support.

### **Professional and Educational Services Revenue**

Our professional services organization provides a variety of consulting, design, application development, deployment, integration, hosting, training, and support services in conjunction with our products. We provide these services through our Professional Services and Education Services groups.

*Professional Services.* The primary goal of our Professional Services organization is to ensure customer satisfaction and the successful implementation of our application solutions. ATG Professional Services has developed an Adaptive Delivery Framework ( ADF ) to ensure consistent, high-quality service delivery throughout all our project engagements. The ADF is used to create repeatable delivery processes from project to project in order to provide a consistent look and feel for all ATG project deliverables. Our Professional Services include four primary service offerings:

*OnDemand Offerings.* By leveraging our experience with the pre-built OnDemand offerings, our Professional Services organization assists our clients with their implementations, thus helping our clients quickly and economically launch their e-commerce and service projects.

*Full-lifecycle Solutions.* We work with our clients from the earliest stages of their projects. The full-lifecycle approach encompasses everything from working with our clients' end users and technical staff to define project requirements to solution design, implementation, usability testing, staging and deployment.

*Custom Solutions.* We can also manage specific areas of our clients' projects, such as designing a solution to meet a client's requirements, implementing scenarios or integrating our solutions with a third-party application.

*Structured Enablement.* In this model, we give our clients the guidance they need while maximizing the skills of the clients' own personnel. Depending on a client's project goals and the expertise of its team, appropriate ATG personnel (such as architects or engineers) work onsite as advisors to aid the client's personnel in areas such as reviewing completed work or advising on a particular project area.

*Education Services.* We provide a broad selection of educational programs designed to train clients and partners on our applications. This curriculum addresses the educational needs of developers, technical managers, business managers, and system administrators. ATG Education Services also offers an online learning program that complements our instructor-led training. Developers can become certified on our base product or our commerce product by taking a certification exam in a proctored environment. We also measure partner quality using a partner accreditation program that ensures ATG partners have the skills necessary to effectively assist our clients with implementations. We provide a full range of instructor-led solutions to assist clients with these key initiatives.

### **Markets**

Our principal target markets are Global 2000 companies and other businesses that have large numbers of online users and utilize the Internet as an important business channel. Our clients represent a broad spectrum of enterprises within



diverse industry sectors, and include some of the world's leading corporations. As of December 31, 2007, we had more than 900 customers.

### **Research and Development**

Our research and development group is responsible for core technology, product architecture, product development, quality assurance, documentation and third-party software integration. This group also assists with pre-sale, customer support activities and quality assurance tasks supporting the services and sales organizations.

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Our research and development activities are primarily directed towards creating new versions of our products, which extend and enhance competitive product features. In 2007, we focused primarily on developing new and innovative applications, integrating and improving our eStara e-commerce optimization services and developing and enhancing our OnDemand offerings.

## **Sales and Marketing**

We market and sell our products and services primarily through our direct sales force, which is compensated based on product and services sales made to our clients, directly or through business partners. We also sell products and services through channel partners, including systems integrators and other technology partners. The majority of our revenue is from direct sales.

Our sales and service organization includes employees in direct and channel sales, system engineers and account management. As of December 31, 2007, we had approximately 100 employees in our sales, marketing and sales support organization, including 63 direct sales representatives whose performance is measured on the basis of achievement of quota objectives. Our direct sales team is comprised of two teams; ATG e-commerce platform sales and eStara e-commerce optimization services sales. Of our 63 direct sales representatives, 15 are located outside the United States.

To support our sales efforts and promote the ATG brands, we conduct comprehensive marketing programs. These programs include industry and partner events, market research, public relations activities, seminars, webinars, advertisements, direct mailings and the development of our website. Our marketing organization supports the sales process and helps identify potential sales and other opportunities. They prepare product research, product planning, manage press coverage and other public relations. As of December 31, 2007, we had 16 employees in our global marketing organization.

As of December 31, 2007, in addition to offices throughout the United States, we had sales offices located in the United Kingdom, France, Canada and Singapore.

## **Strategic Alliances**

We have established strategic alliances with system integrators, technology partners and resellers to augment our direct sales activities. We provide our systems integrators, technology partners and resellers with sales and technical training in order to encourage them to create demand for our products and services and to extend our presence globally and regionally. In addition, we encourage our channel partners to enroll in our accreditation and certification programs. Our ATG Certified Professional Program is a training program for developers to learn more about our products and services, and our ATG Accredited Partner Program is intended to identify our most qualified partners.

## **Competition**

The market for online sales, marketing and customer service software is intensely competitive, subject to rapid technological change, and significantly affected by new product introductions and other market activities. We expect competition to persist and intensify in the future. We currently have the following primary sources of competition:

in-house development efforts by potential clients or partners;

e-commerce application vendors, such as Escalate Retail and IBM;

e-commerce business process outsourcers, such as Digital River and GSI Commerce;

providers of hosted managed service offerings, such as Accenture, EDS and IBM;

providers of hosted on-demand subscription services, such as Demandware, Digital River, MarketLive and Veda;

vendors of marketing and customer-service applications, including natural language, self-service and traditional customer relationship management application vendors; and

commerce optimization vendors, such as Avail Intelligence, Baynote and LivePerson.

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We strive to compete against these alternatives by providing products and services that are richer, offer a more flexible set of capabilities and features and are more reliable and scalable. Our e-commerce products are consistently reviewed as the most feature-rich by the leading industry analysts. Many commerce sites known for their unique and aggressive merchandising are built on our platform. Commerce sites in industries as diverse as fashion, industrial distribution, satellite TV, professional publishing, office supplies and travel are deployed on our commerce platform. Our e-commerce platform is used successfully by several of the highest volume online retailers, powers the highest volume telecommunications site, and has performed for many of our high-volume customers with 100% uptime during peak holiday periods. We believe that our eStara Click-to-Call services are more suitable for enterprise-class corporations, and used by more of them, than competitive products. Our eStara Recommendations service (formerly CleverSet), expected to be available in early 2008, uses more data in its algorithms and is regarded as having more advanced technology than the recommendation solutions offered by our competitors.

## **Proprietary Rights and Licensing**

Our success and ability to compete depends on our ability to develop and protect the proprietary aspects of our technology and to operate without infringing on the proprietary rights of others. We rely on a combination of patent, trademark, trade secret and copyright law and contractual restrictions to protect our proprietary technology. At December 31, 2007, we had 13 issued United States patents, 2 allowed United States patents, 17 pending United States patents, and numerous foreign issued and pending patents. In addition, we have several trademarks that are registered or pending registration in the U.S. or abroad. We seek to protect our source code for our software, documentation and other written materials under trade secret and copyright laws. These legal protections afford only limited protection for our technology, however.

We license our software pursuant to signed master license agreements, as well as click through or shrink wrap agreements, which impose restrictions on the licensee's ability to use the software, such as prohibiting reverse engineering and limiting the use of copies. We also seek to avoid disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements and by restricting access to our source code. Due to rapid technological change, we believe that factors such as the technological and creative skills of our personnel, new product developments and enhancements to existing products are more important than legal protections to establish and maintain a technology leadership position.

## **Employees**

As of December 31, 2007, we had a total of 442 employees. Our success depends on our ability to attract, retain and motivate highly qualified technical and management personnel, for whom competition is intense. Our employees are not represented by any collective bargaining unit, and we have never experienced a work stoppage. We believe our relations with our employees are good.

## **Internet Address and SEC Reports**

We are registered as a reporting company under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Accordingly, we file or furnish with the Securities and Exchange Commission, or the Commission, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K as required by the Exchange Act and the rules and regulations of the Commission. We refer to these reports as Periodic Reports. The public may read and copy any Periodic Reports or other materials we file with the Commission at the Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room is available by calling 1-800-SEC-0330. In addition, the Commission maintains an Internet website that contains reports, proxy and other information regarding issuers, such as Art Technology Group,

that file electronically with the Commission. The address of this website is <http://www.sec.gov>.

Our Internet website is [www.atg.com](http://www.atg.com). We make available, free of charge, on or through our Internet website our Period Reports and amendments to those Periodic Reports as soon as reasonably practicable after we electronically file them with the Commission. We are not, however, including the information contained on

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our website, or information that may be accessed through links on our website, as part of, or incorporating it by reference into, this annual report on Form 10-K.

**Item 1A. Risk Factors**

The following are certain of the important factors that could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this annual report on Form 10-K or presented elsewhere by management from time to time.

***We expect our revenues and operating results to continue to fluctuate for the foreseeable future. If our quarterly or annual results are lower than the expectations of securities analysts, then the price of our common stock is likely to fall.***

Our revenues and operating results have varied from quarter to quarter in the past and will probably continue to vary significantly from quarter to quarter in the foreseeable future. We provide annual guidance on revenues and operating results. A number of factors are likely to cause variations in our operating results, including:

the timing of revenue recognition of our products and services, which is affected by the mix of product license revenue and services provided; due to the growth of our service offerings and evolution of our sales terms with our customers, an increasing portion of our revenue is being recognized ratably over a period of time rather than at the time of invoice and we expect this trend to continue in the near term;

the timing of customer orders, especially larger transactions, and product implementations;

Our ability to cultivate and maintain strategic alliances;

fluctuating economic conditions, particularly as they affect our customers' willingness to implement new e-commerce solutions and their ability to pay for our products and services;

delays in introducing new products and services;

the size of price discounting and concessions;

changes in the mix of revenues derived from products and services;

timing of hiring and utilization of personnel;

cost overruns related to fixed-price services projects;

the mix of domestic and international sales;

variation in our actual costs from our cost estimates related to long term hosting contracts;

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

costs related to possible acquisitions of technologies or businesses.

In any given quarter, we often depend on several relatively large license transactions to meet expected revenues for that quarter. If we expect to complete a large sale to a specific customer in a particular quarter and the sale is not

completed in that quarter, then we are not likely to be able to generate revenue from alternate sources in time to compensate for the shortfall. In addition, as is the case with many software companies, a significant number of our sales transactions are concentrated near the end of each fiscal quarter. If we are unable to close or recognize revenues on even a relatively small number of license deals at quarter-end, then we may not be able to meet expected revenues for that quarter. Because of this concentration of sales at quarter end, customers may seek to obtain higher price discounts than we might otherwise provide by waiting until quarter-end to complete their transactions with us.

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

We operate in a rapidly evolving industry, which makes it more difficult to predict our future operating results. We cannot be certain that our revenues will grow or our expenses will decrease at rates that will allow us to achieve

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profitability on a quarterly or annual basis. Additionally, we expect to recognize an increasing portion of our revenue ratably over a period of time rather than at the time invoice. In the near term, this may have an adverse effect on our revenue and net income, which could result in a decline in the price of our common stock.

### ***Our lengthy sales cycle makes it difficult to predict our quarterly results and causes variability in our operating results.***

We have a long sales cycle, often several months or quarters, because our clients often need to make large expenditures and invest substantial resources in order to take advantage of our products and services and also because we generally need to educate potential customers about the use and benefits of our products and services. This long sales cycle makes it difficult to predict the quarter in which sales may occur. We may incur significant sales and marketing expenses in anticipation of selling 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. Further, our potential customers frequently need to obtain approvals from multiple decision makers before making purchase decisions. Delays in sales could cause significant variability in our revenues and operating results for any particular period.

### ***If the market for e-commerce does not continue to grow, then demand for our products and services may decrease.***

Our success depends heavily on the continued use of the Internet for e-commerce. Many companies continue to rely primarily or exclusively on traditional means of commerce and may be reluctant to change their patterns of commerce. For our customers and potential customers to be willing to invest in our electronic commerce and online marketing, sales and service applications, the Internet must continue to be accepted and widely used for commerce and communication. If Internet commerce does not grow or grows more slowly than expected, then our future revenues and profits may not meet our expectations or those of analysts.

### ***A slowdown in the economy could negatively impact our revenue and earnings.***

General economic conditions affect our customers and sales opportunities. Our ability to achieve our business objectives is affected by many factors, including, among others: general business conditions, interest rates, inflation, taxation, fuel prices and electrical power rates, unemployment trends, terrorist attacks and acts of war, and other matters that influence consumer confidence and spending. Additionally, in the event of an economic downturn, we could experience customer bankruptcies, reduced volume of business from existing customers, delayed or reversal of recognition of revenue due to adverse credit events affecting our customers and bad debt losses, any of which could adversely affect our financial position and results of operations.

### ***If we fail to adapt to rapid changes in the market for online business applications, then our products and services could become obsolete.***

The market for our products is constantly and rapidly evolving, as we and our competitors introduce new and enhanced products, retire older ones, and react to changes in Internet-related technology and customer demands, coalescence of product differentiators, product commoditization and evolving industry standards. We may not be able to develop or acquire new products or product enhancements that comply with present or emerging Internet technology standards or differentiate our products based on functionality and performance. In addition, we may not be able to establish or maintain strategic alliances with operating system and infrastructure vendors that will permit migration or upgrade opportunities for our current user base. New products based on new technologies or new industry standards could render our existing products obsolete and unmarketable.

To succeed, we need to enhance our current products and develop new products on a timely basis to keep pace with market needs, satisfy the increasingly sophisticated requirements of customers and leverage strategic alliances with



third parties in the e-commerce field who have complementary or competing products. 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.

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***We face intense competition in the market for online commerce applications and services, and we expect competition to intensify in the future. If we fail to remain competitive, then our revenues may decline, which could adversely affect our future operating results and our ability to grow our business.***

A number of competitive factors could cause us to lose potential sales or to sell our products and services at lower prices or at reduced margins, including, among others:

Potential clients or partners may choose to develop e-commerce applications in-house, rather than paying for our products or services.

Some of our current and potential competitors have greater financial, marketing and technical resources than we do, allowing them to leverage a larger installed customer base and distribution network, adopt more aggressive pricing policies and offer more attractive sales terms, adapt more quickly to new technologies and changes in customer requirements, and devote greater resources to the promotion and sale of their products and services than we can.

Our suite of service products competes against various vendor software tools designed to address a specific element or elements of the complete set of eService processes, including e-mail management, support, knowledge management, and web-based customer self-service and assisted service.

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.

Some of current and potential competitors, especially our larger competitors like IBM that offer broad suites of computer and software applications may offer free or low-cost e-commerce applications and functionality bundled with their own computer and software products. Potential customers may not see the need to buy our products and services separately when they can use the bundled applications and functionality in our competitors' product suites for little or no additional cost.

***If the market for our OnDemand service offerings does not develop or develops more slowly than we expect, then our business could be negatively affected.***

Our OnDemand hosted service and subscription offerings are at an early stage of development, and we may not achieve or sustain demand for these offerings. Our success in this effort will depend in part on the price, performance and availability of our products and services in comparison with competing products and services and on the willingness of companies to increase their use of hosting applications. While we will continue to market and sell traditional licenses for our software solutions, we believe that the widespread market acceptance of our hosting software solutions is important to the success of our business because of the growth opportunities.

***If our clients experience interruptions, delays or failures in our hosted services, then we could incur significant costs and lose revenue opportunities.***

Our OnDemand hosted services and our eStara e-commerce optimization services are at an early stage of development and any equipment failures, mechanical errors, spikes in usage volume or failure to follow system protocols and procedures could cause our systems to fail, resulting in interruptions in our clients' service to their customers. Any such interruptions or delays in our hosting services, whether as a result of third-party error, our own error, natural disasters or accidental or willful security breaches, could harm our relationships with clients and our reputation. This in turn could reduce our revenue, subject us to liability, cause us to issue credits or pay penalties or cause our clients

to decide not to renew their hosting agreements, any of which could adversely affect our business, financial condition and results of operations.

*We depend heavily on key employees in a competitive labor market.*

Our success depends on our ability to attract, motivate and retain skilled personnel, especially in the areas of management, finance, sales, marketing and research and development, and we compete with other companies for a small pool of highly qualified employees. Members of our management team, including executives with significant