ART TECHNOLOGY GROUP INC
Form 10-K
April 02, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000
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	04-3141918
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

25 First Street, Cambridge, Massachusetts 02141
Jeet Singh
Chief Executive Officer
Art Technology Group, Inc.
25 First Street
Cambridge, Massachusetts 02141
(617) 386-1000

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $0.01 par value
(Title of Class)

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

Indicate by check mark 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 attachment to this Form 10-K. |_|

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $ based on the closing price of the Common Stock on the NASDAQ National Market on March , 2001.

The number of shares of the registrant's Common Stock outstanding as of March , 2001, was .

Documents Incorporated by Reference

DOCUMENT DESCRIPTION	10-K PART
Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held May 14, 2001.................	III

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PART I

Item 1 BUSINESS

Overview

We offer an integrated suite of Internet customer relationship management and e-commerce software applications, as well as related application development, integration and support services. Our solution enables businesses to understand, manage and build online customer relationships and to market, sell and support

products and services over the Internet more effectively. Our Dynamo product suite includes an application server that is specifically designed to enable and support Web applications, as well as e-commerce and Internet customer management applications. An application server is a software program that facilitates the development, deployment and management of other software programs. Our solution is designed to provide businesses with the core application platform and software tools required to develop and deploy personalized, reliable, large-scale Web sites for conducting e-commerce.

INDUSTRY BACKGROUND

GROWTH OF THE INTERNET AND ELECTRONIC COMMERCE

The emergence of the Internet as a global medium for interactive communications and commerce is fundamentally changing the way business is conducted. The Internet is enabling businesses to attract and retain customers, conduct e-commerce with those customers, and communicate with employees, suppliers and strategic partners. The Internet is providing the opportunity for businesses to establish new revenue streams, create a new distribution channel, reduce costs and increase customer retention. This opportunity has driven the growth in online marketing and e-commerce initiatives. International Data Corporation estimates that more than $2.6 trillion worth of goods and services will be sold over the Internet by 2004, which represents a compounded annual growth rate of 82% for the period between 1999 and 2004.

As the growth and acceptance of online marketing and e-commerce have increased, the World Wide Web has become a highly competitive business environment where customers have a large number of easily accessible choices. For a company to succeed in this environment, its Web site must present content and provide an overall visitor experience that captures the visitor's interest and satisfies their informational and transactional needs. To accomplish this, companies are investing in Internet-based customer relationship management and e-commerce solutions, such as:

- online marketing and selling systems to target, attract and retain customers;

- transaction and distribution management systems to reduce the costs of delivering products and services to customers and distribution partners; and

- customer support and relationship management systems to better understand and serve the ongoing needs of their customers.

EMERGING E-COMMERCE REQUIREMENTS

Many commercial Web sites present only a static collection of non-interactive content. These sites offer basic content, such as corporate information, product literature and banner advertisements, which are passively viewed by Web visitors. While this information is useful, many Web visitors prefer dynamic content, which is continually updated and enhanced, as well as interactive content, which responds and changes based on the user's input. Many Web visitors also prefer Web sites that personalize their experience and present more relevant content based on their existing relationship with the business, stated

or implied preferences and needs, Web navigation behavior and other factors. To attract, serve and retain customers online, businesses must engage visitors with dynamic, relevant and targeted experiences, which often lead to transactional opportunities.

Businesses are seeking Web-based systems that can be dynamically updated and integrated, sharing data among Web applications and across their entire enterprises in order to present users with a personalized, consistent and unified customer experience. The desired result is a customer-driven Web site that takes into account the particular customer's profile, Web behavior and relationship with the company. Customer-driven Web sites can provide businesses with an efficient means to manage and maximize customer relationships online. In order to accomplish this, businesses require solutions that incorporate a number of features:

- EFFECTIVE CONTROL OF E-COMMERCE SYSTEMS AND STRATEGIES. Business managers responsible for Internet customer relationship management need easy-to-use tools to give them direct control over their e-commerce systems and strategies without requiring the time-consuming intervention of information technology specialists. With the appropriate tools, business managers can better manage their Internet customer relationships through improved customer segmentation and delivery of targeted content, promotions and advertising campaigns, and personalized pricing and account information.

- INTEGRATION WITH EXISTING INFORMATION SYSTEMS. In order to present the customer with a unified and personalized e-commerce experience, companies must address the difficult challenge of integrating Web applications with their existing content management, customer database, transaction and customer support systems.

- COMMON PLATFORM UPON WHICH TO BUILD FUTURE APPLICATIONS. Businesses implementing sophisticated Web-based applications desire an expandable Web platform to enable them to build new applications and add third-party functionality to their e-commerce initiatives on a rapid and ongoing basis.

- SCALABILITY, PERFORMANCE AND RELIABILITY. The increasing significance of Web-based commerce requires that e-commerce systems be highly scalable in order to accommodate rapid user growth and increased Web site complexity, content and functionality. Scalability refers to the ability of a computer system to handle greater load by adding additional hardware. Further, companies need high performance and highly reliable systems because if online systems fail or cause unsatisfactory delays, even for a short period of time, businesses could miss revenue opportunities and lose customers.

CURRENT SOLUTIONS

In response to these emerging business requirements, various applications have been developed that address discrete aspects of the enterprise e-commerce infrastructure. A number of vendors offer stand-alone solutions for Web content management, advertising management, transaction processing, e-commerce storefront development, personalization and recommendation engines, and application development tools. By implementing a collection of these stand-alone solutions, companies can attempt to deliver dynamic, personalized content to Web site visitors and manage their e-commerce efforts. However, these stand-alone solutions may not provide a satisfactory solution for many businesses:

- LACK OF INTEGRATED FUNCTIONALITY. Disparate stand-alone applications generally do not easily integrate and communicate with each other, lack a common user interface and lack a common platform for integrating with existing information systems. As a result, a collection of stand-alone applications often does not present the Web visitor with a unified customer experience and may sacrifice functionality and performance.

- HIGH COST. It is frequently difficult and expensive for companies to implement a solution consisting of a collection of disparate stand-alone solutions from multiple vendors, and these implementations frequently fail to meet requirements. In addition, businesses often incur higher costs of ownership over time as it is difficult for them to manage the uncoordinated product upgrade cycles and new application development efforts of multiple vendors.

Today, businesses increasingly seek an integrated package of applications, platforms and tools that addresses all aspects of their enterprise e-commerce infrastructure, rather than just stand-alone solutions. Some software providers have developed more comprehensive solutions incorporating a number of e-commerce functions. However, these solutions may be inadequate for a number of reasons:

- LIMITED FUNCTIONALITY. The functionality may be insufficient to serve all of a company's e-commerce requirements, resulting in the need to buy, build or adapt additional applications.

- LACK OF A MODULAR, APPLICATION SERVER-BASED ARCHITECTURE. These solutions are typically not built with separate software modules and lack the expandability that an application server-based platform provides. This limits the ability of businesses to customize their implementations, integrate their solutions with existing applications and extend their e-commerce initiatives by building future applications or incorporating third-party technology.

- POOR SCALABILITY AND RELIABILITY. Most of today's computer systems are unable to scale to meet the growing performance demands of large-scale, e-commerce Web sites. Solutions that do not scale well can be unreliable and subject to system failures, which may result in frustrated customers, lost revenue opportunities and potential financial losses.

To address the limitations of most commercially available solutions, some companies have built custom Internet customer relationship management solutions with application development tools. While these solutions can provide the required functionality and integration, they typically require lengthy implementation periods and are expensive to build and maintain. In addition, they require a comprehensive understanding of market segmentation, content targeting and advertising, as well as extensive technical expertise in Web application development and systems integration. Most companies, and many third-party systems integrators and application developers, do not have the expertise and experience to address all of these requirements.

As a result, businesses are increasingly seeking Web application software providers offering products and professional services that enable them to rapidly deploy comprehensive, effective Internet customer relationship management solutions. Businesses prefer solutions that are modular and flexible

with an open, application server-based architecture. They desire solutions that are easy to integrate with existing systems and third-party applications and that enable them to extend their Web infrastructures with new applications and functionality to meet their continually evolving e-commerce needs. Businesses also need to leverage their existing business systems, strategies and expertise to manage their customer relationships effectively. Finally, businesses are seeking solutions that meet the demanding scalability, reliability and performance requirements of large-scale Web sites that conduct e-commerce.

OUR SOLUTION

We offer a suite of Internet customer relationship management and e-commerce software applications, as well as related application development, integration and support services. Our solution enables businesses to understand, manage and build their online customer relationships more effectively and to market, sell and support their products and services over the Internet.

Our product suite includes Dynamo Application Server, an application server specifically designed to enable and support Web applications. Dynamo Application Server is designed to provide businesses with the core application platform and

software tools required to develop and deploy personalized, effective e-commerce Web sites. Our product suite also includes Dynamo Personalization Server, Dynamo Scenario Server and Dynamo Commerce Server. Dynamo Personalization Server is an expandable personalization platform that enables companies to target specific content and data to particular customers or visitors on the Web. Dynamo Scenario Server allows non-technical business managers to define e-business scenarios, which are scripted sequences of customer interactions that manage ongoing business relationaships. Dynamo Commerce Server manages and delivers product catalog content and personalized, scenario-based merchandising programs and provides transaction processing capabilities for large-scale e-commerce storefronts.

Our solution incorporates the following distinguishing characteristics:

AN INTEGRATED AND MODULAR PRODUCT SUITE BASED ON A COMMON PLATFORM. Our product suite includes a comprehensive range of functionality that allows businesses to quickly develop and deploy personalized Web-based e-commerce applications. Our application server-based platform enables our Dynamo applications to share data and work together more efficiently than would a collection of discrete Web applications from different vendors using various technologies. An integrated product suite based on a common platform also ensures that new products and releases will be compatible with each other as well as with other applications built on Dynamo Application Server. The modularity of our product suite allows customers to purchase applications that fit their particular needs and allows them to quickly expand their implementations as required.

RULES-BASED PERSONALIZATION IMPLEMENTED BY BUSINESS MANAGERS. Our products allow business managers to apply new and pre-existing business rules to profile and segment users and dynamically deliver personalized content and data to online visitors. For example, businesses can present different prices, products and promotional offers to different visitors or they can deliver customer-specific information such as account detail and purchase history. Business managers can review the behavior of visitors and quickly adjust their business rules to manage their online marketing communications and e-commerce strategies.

E-BUSINESS SCENARIO-BASED CUSTOMER INTERACTION. Our products allow non-technical business managers to define, manage and analyze customer interactions that take place across both Web and non-Web based communication channels. For example, a business manager can use a point-and-click visual interface to create an

e-business scenario that reacts to a new customer visit by offering an incentive to sign up as a registered user. If the user takes advantage of the offer by registering, the scenario might pause for several weeks and send a personalized e-mail reminding the user to return. Finally, the scenario might be configured to trigger a follow-up phone call after several repeat visits to enable a customer care representative to build a more personal relationship with a highly qualified customer.

HIGH SCALABILITY, RELIABILITY AND PERFORMANCE. Our Dynamo Application Server employs a Java-based architecture that is highly scalable. It has a dynamic load management system which allows applications to be distributed across multiple server computers. This means that as a Web site becomes more heavily utilized, additional computing resources can be added to handle the additional load. The load management system provides redundant fail-over, a feature that transfers users on a failed server to another server without interruption. Dynamo Application Server has been designed to meet the performance requirements of high-capacity, highly personalized e-commerce Web sites.

OPEN AND EXPANDABLE APPLICATION SERVER ARCHITECTURE. Our Dynamo Application Server provides customers with an expandable platform that allows them to rapidly integrate our products with their existing systems and to deploy new applications, both internally developed and from third parties. The ability to integrate multiple applications and information systems with our common platform enables businesses to incorporate organization-wide customer data and support systems to provide a unified customer experience. In addition,

our open, application server-based platform and the modularity of our product suite enable systems integrators and technology partners to develop their own proprietary applications on Dynamo for reuse or resale.

PROFESSIONAL SERVICES CAPABILITIES. We have been designing and deploying network-based applications for over eight years and Web sites for over five years. We have two primary service offerings, Innovation Solutions and Express Services. Our Innovation Solutions team provides customized application design, development and integration services to clients who desire advanced solutions that are not commercially available. We provide Innovation Solutions services for a limited number of projects that we believe will provide us with an understanding of emerging technical and business needs for our future products. Our Express Services team provides strategic consulting and integration support services to customers and systems integrators to facilitate the deployment of our products. Express Services provides system architecture design, project management, Web design and technical training and support.

Our solution provides our customers with:

EFFECTIVE, HIGH-PERFORMANCE E-COMMERCE WEB SITES THAT ARE:

- dynamically generated and personalized on a real-time basis
- highly functional with comprehensive e-commerce features
- able to personalize content based on easily modifiable business rules
- able to increase customer satisfaction and retention
- able to present a unified, customer-centric experience by integrating various sources of customer data and content and leveraging existing information systems
- designed by business managers to further their overall business

strategies

THE ABILITY TO ACHIEVE RAPID TIME TO MARKET BY:

- deploying our comprehensive suite of integrated applications
- enabling rapid integration with existing information systems
- taking advantage of our intuitive user interfaces for business managers and application developers
- utilizing our experienced consulting services professionals

THE ABILITY TO ACHIEVE A COMPETITIVE ADVANTAGE AND A HIGHER RETURN ON INVESTMENT BY:

- increasing e-commerce and advertising revenues
- improving marketing effectiveness
- reducing marketing, transaction and customer support costs
- increasing customer satisfaction and retention

STRATEGY

Our objective is to be a leading provider of Internet customer relationship management solutions. To achieve this objective, we have adopted the following strategies:

MAINTAIN AND EXTEND PRODUCT AND TECHNOLOGY LEADERSHIP. We believe we are a technology leader in providing Internet customer relationship management solutions. We offer a comprehensive suite of software applications that we believe are based on an advanced technologies. We were one of the first companies to market a high-performance dynamic Web page generation engine to both generate and deliver Web pages on a real-time basis, and shipped our first Java-based Web application server shortly after Sun Microsystem's first commercial shipment of Java 1.0. In September 2000 we began shipping Dynamo 5 E-Business Platform, which we believe was the first fully certified J2EE customer management solution to be commercially available. We intend to extend our product and technology leadership by:

- extending Dynamo's personalization capabilities and building new Internet customer relationship management applications
- continuing to increase the scalability, reliability and performance of our Dynamo applications
- continuing to develop new connector modules to allow our products to easily integrate with third-party Internet customer relationship management products, databases and information systems
- providing Dynamo Application Server support for emerging industry standards, such as XML,for formatting data and other information, and WML, for serving content to wireless devices;and
- using our Innovation Solutions services to identify emerging market needs.

GROW AND LEVERAGE PROFESSIONAL SERVICE CAPABILITIES. We have extensive

experience in Web application development and integration services. Through our Express Services, we provide enabling services to train our systems integrators and technology partners in the use of our products as well as consulting services to assist with customer implementations. We plan to create additional opportunities to increase revenues from product sales by continuing to expand our base of partners trained in the implementation and application of Dynamo. We intend to hire additional professional services personnel to increase our services revenues and to enable and support product license sales through systems integrators.

CONTINUE TO BUILD DIRECT SALES CAPABILITIES AND LEVERAGE CO-SELLING EFFORTS WITH SYSTEMS INTEGRATORS AND WEB DEVELOPERS. We sell our products directly to end-users and through co-selling efforts with systems integrators and Web developers. We currently have more than 250 system integrators and technology partners, including Adobe Systems, Cap Gemini Ernst & Young, CSC, Deloitte Consulting, E.piphany, E-Tree, Fort Point Partners, PricewaterhouseCoopers and Sun Microsystems. Our objective is to establish close relationships directly with our customers and to motivate systems integrators to implement the Dynamo technology and product suite on Internet and Web-based projects for their customers. We intend to expand our sales by hiring additional direct sales personnel, domestically and internationally, both to sell directly to end-users and to expand our co-selling efforts. We plan to leverage our current relationships and develop additional co-selling relationships with leading systems integrators. In addition, many of our systems integrators are global enterprises, which we believe provides us with an opportunity to expand our international business.

EXPAND TECHNOLOGY PARTNER AND ORIGINAL EQUIPMENT MANUFACTURER RELATIONSHIPS AS A DISTRIBUTION CHANNEL. Our technology partners include Adobe Systems, Documentum, E.piphany, Interwoven and Sun Microsystems. We work with some of our technology partners to develop modules that enable our software products to operate with their software products. We also work with original equipment manufacturers to enable them to combine our software products with their products to form a single software application product. Some of our customers have requirements that can be met by a combination of our products and

those of one or more of our partners. We sell in conjunction with these vendors in a variety of ways:

- co-marketing with a technology partner to promote the fact that our products operate together;
- co-selling with a partner in an arrangement where sales and service personnel from both organizations approach a customer in a coordinated sales process
- selling to reseller partners; and
- selling to original equipment manufacturers that sell and support the combined product.

Many of our current and potential partners are looking to extend their current offerings to include Web-enablement, personalization and e-commerce features. We believe these relationships will provide us the opportunity to establish our platform in additional markets.

EXPAND MARKET PRESENCE. We intend to increase our domestic and international market presence through a variety of marketing and sales programs designed to generate market awareness, penetrate target markets and help establish us as the leading provider of Internet customer relationship management solutions. We plan

to increase spending on advertising, trade shows, seminars, industry events and direct marketing efforts. We also plan to devote marketing resources to expanding our channel relationships with systems integrators and technology partners. We intend to develop and promote the Dynamo brand alongside our partners' brands in all co-marketing relationships.

PURSUE STRATEGIC ACQUISITIONS. We intend to pursue acquisitions of, or, investments in, complementary businesses and technologies. In particular, we will seek to identify opportunities to acquire personnel that will help us increase the breadth of our solution, provide us with additional technological expertise and expand our geographical presence.

PRODUCTS

We offer an integrated suite of Internet customer relationship management applications. Our core product is Dynamo Application Server, a dynamic Web page generation engine and application server specifically designed to enable and support Web applications, that provides businesses with the platform and software tools to develop and deploy personalized, effective e-commerce Web sites. Our product suite also includes Dynamo Personalization Server, Dynamo Scenario Server, and Dynamo Commerce Server. Each of the applications in our product suite can be purchased separately; however, the Dynamo Application Server is required to run each of our other applications. Dynamo Personalization Server is required to run Dynamo Scenario Server, and Dynamo Scenario Server is required to run Dynamo Commerce Server. We also sell software tools to enable rapid application development, as well as adaptor modules to integrate dynamo products with content management systems. Our product suite is designed to meet the performance and scalability requirements of large-scale e-commerce Web sites. All of our products are based on Java.

The following table briefly describes the product included in our Dynamo 5 e-Business Platform, including list prices and system requirements.

PRODUCT	DESCRIPTION	LIST
APPLICATION SUITE		
Dynamo Application Server	An open and expandable Java-based platform designed for the development and deployment of high-performance, dynamic Web applications.	$15,000
Dynamo Personalization Server	A platform designed to allow businesses to manage customer profiling and dynamic content targeting. Ensures that the right content gets to the right users at the right time.	$20,000 Applicat
Dynamo Scenario Server	A platform for defining, delivering and analyzing E-business scenarios, which are customized sequences of targeted interactions that allow businesses to create customer relationships across the entire lifecycle.	$30,000 Applicat Personal
Dynamo Commerce Server	A complete storefront solution for business-to-consumer and business-to-business e-commerce. Enables	$35,000 Applicat Server a

	businesses to create personalized shopping experiences within a complete, rapidly deployable online selling environment.	
TOOLS AND INTEGRATION MODULES		
Dynamo Control Center	An integrated interface to the administrative, development and business tools in the Dynamo E-Business Platform.	Single-s servers addition
Dynamo Connectors	Adaptors that provide direct integration with leading content management systems and other enterprise applications.	$10,000

DYNAMO APPLICATION SERVER. The Dynamo Application Server is designed to provide businesses with the core application platform and software tools required to develop, deploy and manage personalized, effective Web sites for conducting business on the Internet. The Dynamo Application Server provides a common application platform for:

- dynamically generating Web pages and managing user sessions;
- supplying a framework of shared application services to connect and integrate each of the applications in our product suite;
- managing the distribution of applications across multiple computers and providing an automatic recovery management system to prevent system failures; and
- efficiently connecting to enterprise systems and third-party applications.

Dynamo Application Server connects to Dynamo Control Center, a Web application development tool that allows developers and Web designers to build new applications and integrate third-party technologies.

DYNAMO PERSONALIZATION SERVER. Dynamo Personalization Server coordinates, manages and centralizes the personalization functions of the Dynamo product suite. Dynamo Personalization Server enables business managers to segment users and target content based on new and pre-existing business rules. It adjusts and personalizes Web content on a real-time basis by combining explicit user data from existing customer management and marketing databases with implicit information gathered on Web navigation behavior.

Dynamo Personalization Server performs the following functions:

- PROFILE GATHERING. When a visitor first arrives at a Web site, a profile is created automatically for that visitor. If the visitor registers or logs in, the visitor's identity is added to the profile, preserving any profile information that was gathered up to that point. Dynamo Personalization Server tracks both explicit user profile data supplied by the user as well as implicit profile attributes derived from the user's behavior on the Web site. This information is combined with any existing information about the visitor from the company's internal databases.
- SEGMENTATION AND CONTENT TARGETING. Dynamo Personalization Server enables business managers to segment visitors based on their profile

data. Using business rules, content can be personalized and targeted to these groups of users. These business rules are created using the Dynamo Control Center.

- CONTENT MANAGEMENT AND INTEGRATION. In addition to using Dynamo Personalization Server to target content residing on internal file systems, customers may purchase Dynamo Connectors to integrate Dynamo with leading content management systems and other enterprise applications. The Dynamo Connectors provide direct integration to leading content management systems such as those from Documentum and OpenText.

- PERSONALIZED MESSAGING. Dynamo Targeted E-mail can be used with the Dynamo Personalization Server to send personalized messages to selected groups and individual Web site users.

DYNAMO SCENARIO SERVER. Dynamo Scenario Server provides a platform for non-technical business managers to define, manage and analyze e-business scenarios, which are planned sequences of interactions with a specific customer or customer segment that enable businesses to manage long-term customer relationships. E-business scenarios can span a wide variety of customer interactions across multiple channels including customer acquisition and retention, product discounts and promotions, cross-sell and up-sell incentives, product fulfillment, and customer support functions. Dynamo Scenario Server features include:

- "POINT-AND-CLICK" VISUAL INTERFACE. Dynamo Scenario Server features a point-and-click visual interface, integrated in the Dynamo Control Center, which enables non-technical business managers to define and manage e-business scenarios by manipulating graphical scenario elements. These elements include people, time, events, conditions and actions. This visual interface allows the managers to create and manage e-business initiatives without requiring skilled computer programming personnel.

- TIGHT INTEGRATION WITH DYNAMO PERSONALIZATION AND COMMERCE SERVERS. Dynamo Scenario Server is tightly integrated with the Dynamo Personalization Server and Dynamo Commerce Server products, so that e-business scenarios can automatically take advantage of information and configurations in those products. For example, e-business scenarios can be defined to only apply to customer segments that are identified through the Dynamo Personalization Server. When used in conjunction with Dynamo Commerce Server, e-business scenarios automatically present commerce related events and actions such as purchasing events and shopping cart discounts, integrated reporting and graphing.

- SCENARIO TEMPLATES. Dynamo Scenario Server allows the creation and use of Scenario Templates, which are reusable, pre-built e-business scenarios that omit a small number of parameters. When a Scenario Template is re-used, the business manager is asked for the omitted parameters and the scenario is created. Scenario Templates enable business managers to quickly initiate commonly used scenarios and to simplify the creation of scenarios for less sophisticated users.

DYNAMO COMMERCE SERVER. Dynamo Commerce Server is a flexible solution enabling businesses to deploy and manage large-scale, personalized, e-commerce storefronts. Dynamo Commerce Server delivers product catalog content and scenario-based, promotional merchandising programs to manage the online shopping experience. It is designed to integrate with existing customer database,

inventory, order processing, payment and fulfillment systems operated by many large organizations. In addition, Dynamo Commerce Server provides administration features that allow e-commerce storefronts to be operated independently by various managers throughout an organization. The Dynamo 5 version of Dynamo Commerce Server offers gift registries, coupons, carts and shipping addresses, support for multiple currencies and an improved administration interface. The Dynamo Commerce Server is also tightly integrated with Dynamo Scenario Server so that commerce transactions and merchandising features can interact effectively with e-business scenarios. Dynamo Commerce Server features also include:

- COMPLETE E-COMMERCE STOREFRONT SOLUTION. Dynamo Commerce Server provides a comprehensive set of e-commerce storefront functions including catalog, shopping cart, order processing, built-in search capabilities and user registration. Business managers can customize the layout, look and feel, navigation and functionality of their storefronts through point and click interfaces and through customized Web page templates. Dynamo Commerce Server supports both business-to-business and business-to-consumer e-commerce.

- ENVIRONMENT FOR PERSONALIZED SELLING. Web sites built on Dynamo Commerce Server can be designed to deliver targeted merchandising campaigns based on user profiles gathered through Dynamo Personalization Server and driven by e-business scenarios defined through Dynamo Scenario Server. Since Dynamo Commerce Server uses both implicit and explicit profiles, content can be targeted to both anonymous and recognized visitors. Reporting functionality allows marketing personnel to gather real-time feedback on the effectiveness of various targeting and merchandising strategies.

- FLEXIBLE ORDER PROCESSING. Dynamo Commerce Server provides core order processing functionality that can be integrated with a wide variety of transaction models and existing business processes. Through the use of our integration modules, customers can incorporate business systems into the order processing flow at a number of stages as products are browsed, selected and purchased.

- CUSTOMIZATION, MAINTAINABILITY AND DAY-TO-DAY MANAGEMENT. Dynamo Commerce Server allows business managers, designers and programmers to independently maintain and manage the various aspects of the Web site relating to their particular expertise. Dynamo Commerce Server has an administrative interface, integrated into the Dynamo Control Center, so business managers can control product presentation, pricing and promotions. Designers can directly customize Web site templates upon which the site is built. The open, modular architecture makes it easy for programmers to extend and modify functionality. This separation simplifies deployment and ongoing maintenance.

SERVICES

We provide a variety of consulting, design, application development, integration and training and support services in conjunction with our products through our Innovation Solutions and Express Services offerings.

INNOVATION SOLUTIONS. Innovation Solutions services consist of customized application design, development and integration services and are ordinarily provided on a fixed-price basis. We have extensive experience in developing, designing and deploying large-scale Web applications. Our Innovation Solutions services are provided to clients with complex requirements that seek advanced solutions that are not commercially available to extend the capabilities and

features of their systems. As well as being a core component of our business, Innovation Solutions projects provide us with an understanding of emerging customer requirements and insights for new product developments. We typically select projects that we believe may provide the technical and functional foundation for our future products and services.

EXPRESS SERVICES. Express Services consist of high level consulting and enabling support services such as system architectural design, project management, Web site design, and technical training and support. Express Services are ordinarily provided on a time and materials basis. Our Express Services are provided to assist systems integrators, development partners and customers to rapidly develop and deploy Dynamo-based applications and systems. Our objective is to deploy our Express Services quickly and efficiently to reduce the time and effort required by our partners and customers to successfully deploy Dynamo applications. Our Express Services are priced on a per day basis.

CUSTOMER SUPPORT AND MAINTENANCE. We offer five levels of customer support ranging from our evaluation support program, which is available for 30 days, to our Premier Support Program, which includes telephone support 24 hours a day, seven days per week, for customers deploying mission critical applications. Customers are entitled to receive software updates, maintenance releases and technical support for an annual maintenance fee of 20% to 30% of the then-current list price of the licensed product.

TRAINING. We provide a broad selection of training for customers and partners, including programming classes covering all of the components of our product suite. Training is priced on a per day basis. Fees vary for standard public training classes and on-site private training classes.

CUSTOMERS

We have delivered e-business solutions to more than 660 companies worldwide. Our principal target markets are Global 2000 companies, as published by Forbes, as well as leading companies using the Internet as a primary business channel. Our customers represent a broad spectrum of enterprises within diverse industry sectors. The following is a partial list of customers that have purchased licenses and/or professional services from us:

CONSUMER RETAIL
BlueLight.com
CareSoft
J.Crew
Target
Walgreens

FINANCIAL SERVICES
John Hancock Funds, Inc.
KeyBank
Scudder Kemper Investments

INTERNATIONAL
Direckt Analge Bank
Gameplay
Kingfisher

INTERNET
Loudcloud
TechRepublic
TheStreet.com

MANUFACTURING
3M
Abbott Laboratories
Eastman Kodak
Procter & Gamble

TECHNOLOGY
BellSouth
Informix
Network Solutions
Newbridge Networks
Sun Microsystems

TRAVEL, MEDIA AND ENTERTAINMENT
BMG Direct
Hilton Hotels
MTVi
Sony Online Entertainment

TECHNOLOGY

We believe we are a technology leader in providing Internet customer

relationship management solutions. Our technology leadership has been evidenced by product awards and recognition by industry commentators. We believe our technology enables our customers to create, deploy and maintain large-scale, personalized e-commerce Web applications in less time and at a lower cost than existing alternatives. We believe that our products have the following technological advantages:

JAVA FOUNDATION

Our products are written entirely in Java and support Java programming for customization and extension, except for a few integration and installation modules that can be implemented only in conventional programming languages. We have performed internal tests to certify that our Dynamo 5 e- Business Platform supports the J2EE standards established by Sun Microsystems.

We believe that our Java implementation results in the following benefits:

- STRONG COMPONENT MODEL. Java provides a component standard known as "JavaBeans," which enables developers to segment their code into discrete, well-defined units which can be assembled in a "building block" fashion to create new applications. JavaBeans' modularity makes it easier to create reusable software as well as maintain existing systems.

- PLATFORM NEUTRALITY. Java's portability allows our applications to be run on virtually any major computer system without modification. This portability eliminates porting costs normally required to support multiple platforms or to change platforms, while allowing us to release products on major platforms simultaneously.

- ENTERPRISE INTEGRATION. We believe that Java's portability and direct support for distributed applications are helping Java to become the de facto standard language for enterprise system integration. We expect that Sun Microsystems' establishment of J2EE standards will make integration even easier for those enterprise systems that support J2EE specifications.

- FEWER PROGRAMMING ERRORS. Java's automatic memory management reduces memory corruption errors, which typically represent the most costly and difficult software "bugs" in conventional compiled languages such as C or C++.

- ACCELERATED DEVELOPMENT. We believe that the above features, combined with the broad availability of high-quality Java development tools, result in faster development time.

MODULAR, STANDARDS-BASED COMPONENT ARCHITECTURE

One of the key features of our product architecture is its high degree of modularity, achieved by building additional functionality on top of the JavaBeans component technology. Customizations and extensions built by our customers or partners using industry standard JavaBean components can be managed by Dynamo Application Server. Dynamo Application Server enhances the naming, configuration and lifecycle of each component, allowing components to be added, extended, duplicated or replaced without recompilation of the rest of the system. The modularity of our component technology allows our products to be adapted to meet future business needs. In contrast, producers of non-modular products must try to anticipate and develop additional functionality at the time that they market their products.

One of the most powerful uses of our component technology is to integrate our software with external enterprise systems. We provide reference implementations of integration components while enabling our customers and partners to easily replace our reference components with new components that provide the same function but integrate with their existing systems. We adhere to industry standards to enable our products to leverage technologies produced by third parties and to protect the development investments of our partners and customers.

PERFORMANCE, SCALABILITY AND RELIABILITY

Our products have a layered architecture. Dynamo Personalization Server is built on top of Dynamo Application Server, Dynamo Scenario Server is built on top of Dynamo Personalization Server, and Dynamo Commerce Server is built on top of Dynamo Scenario Server. We believe that the integration of Dynamo Application Server with our other products yields significant benefits, particularly in performance, scalability and reliability.

Dynamo Application Server uses page compilation technology to enhance the performance of Web page generation. In most dynamic page generation servers, a Web page is generated from an HTML template, a Web page that is mostly standard HTML content with special embedded instructions to generate the dynamic portions of the page. We utilize this basic page template model, but unlike most other servers, Dynamo Application Server converts the HTML template into Java source code and compiles it into executable binary classes. This page compilation technology improves the speed at which Dynamo Application Server can generate and serve dynamic Web pages.

Scalability is a term used to describe the ability of an application to handle greater load when additional hardware is added to a system. Scalability is particularly important for e-commerce applications where demand can grow dramatically and unpredictably. Dynamo handles scalability across computers through a dynamic session-based load management system in which multiple copies of the application are run on multiple computers. This load distribution scheme has the advantage of accommodating additional users by adding more computers. Our load management technology also enables our applications to handle computer hardware failures automatically and without interrupting the user's experience. If a computer fails, users are automatically reassigned to another running computer.

RESEARCH AND DEVELOPMENT

Our research and development group is responsible for product management, core technology, product architecture, product development, quality assurance, documentation and third-party software integration. This group also assists with pre-sale and customer support activities referred from the Express Services group and quality assurance tasks supporting the Innovation Solutions group.

Since we began focusing on selling software products in 1996, the majority of our research and development activities have been directed towards creating new versions of our products which extend and enhance competitive product features, particularly in the areas of integrating our products with external enterprise systems, supporting emerging industry standards and creating more powerful user interfaces to our products. The systems we integrate with include relational databases, content management systems and credit card payment servers. The industry standards we support include Java Servlets, a standard for constructing Web pages using the Java programming language; J2EE standards for developing modular Java programs that can be accessed over a network; and Simple Network Management Protocol, a standard for remotely

monitoring the operation of a system.

SALES AND MARKETING

Our principal target markets are Global 2000 companies and leading companies using the Internet as a primary business channel. We target these potential customers through our direct sales force and through arrangements with systems integrators, Web developers, original equipment manufacturers and other technology partners. We currently have more than 250 system integrators and technology partners.

We employ one group of sales professionals who are compensated based on product sales made directly to end-users, a second group of regional service account managers who are compensated based on service sales made directly to end-users and a third group of sales professionals who are compensated based on sales made through co-selling efforts with our systems integrator partners. We train and assist systems integrators in promoting, selling, deploying, extending and supporting our products. The objective of this strategy is to establish close product relationships directly with our customers and to motivate systems integrators to adopt the Dynamo technology and suite of products on Internet and Web-based projects for their clients.

In addition, we have initiated a strategy to co-market our products with technology partners and to sell our products through original equipment manufacturers. We intend to increase sales of our products by entering into similar relationships with additional technology partners and original equipment manufacturers.

Our co-marketing relationships are with major systems integrators that serve the market for information system products and services. The objective of this co-marketing strategy is to motivate systems integrators to adopt the Dynamo technology and suite of products on Web-based projects for their clients. We train and assist our systems integration partners to enable them to deploy, extend and support our products.

Set forth below is a partial list of organizations with which we have selling and marketing relationships:

NORTH AMERICA
Adobe Systems
Cap Gemini Ernst & Young
Centrifusion
Context Integration
CSC
Deloitte Consulting
Documentum
E.piphany
Fort Point Partners
Informix
Inventa
Interwoven
iXL
KPMG
Luminant
marchFIRST
Modem Media
Organic
PricewaterhouseCoopers
Sapient
Sun Microsystems

INTERNATIONAL
Digital Channel Partners
E-TREE
Fi SYSTEM
Icon Medialab
MATERNA
Quidnunc

As of December 31, 2000, we had sales personnel located at our offices in Australia, Canada, England, France, Germany, Hong Kong, Italy, the Netherlands, Singapore and Sweden. During the past year, we have established relationships with new international partners and have added key international accounts. We intend to continue our international expansion by working with additional global and local partners and by creating additional

local infrastructure to provide direct sales, service and marketing. While we will continue to focus our international sales efforts principally on Europe, we also will seek to expand our presence in the Asia/Pacific region, including Japan and Singapore.

COMPETITION

The market for Internet customer relationship management solutions is intensely competitive, subject to rapid technological change and significantly affected by new product introductions and other market activities of industry participants. We expect competition to persist and intensify in the future. We have three primary sources of competition:

- in-house development efforts by potential customers or partners;
- Internet applications software vendors, such as Blue Martini, BroadVision and Vignette; and
- platform application server products and vendors, such as BEA Systems, IBM's Websphere products, and Microsoft, among others.

We also compete in the platform application server market with the Netscape/Sun Alliance iPlanet Application Server product, which is partially controlled by Sun Microsystems. Sun is one of our customers and co-marketing partners.

We believe the primary factors upon which we compete are the functionality and expandability of our products, the extent to which our products integrate with other systems, our prices and our ability to provide quality services to assist our customers and partners. We believe that we have competitive advantages that differentiate our products and services from those of our competitors. Our application suite provides improved time-to-market and lower cost of ownership in comparison to in-house development efforts. We believe the expandability and scalability of our application server-based platform, as well as our product features, provide us an advantage over other Internet application software vendors. We believe the functionality provided by the personalization and e-commerce components of the Dynamo application suite gives us a competitive advantage over platform application server vendors.

Despite these advantages, many of our competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do. As a result, they may be able to undertake more extensive promotional activities, offer more attractive pricing and purchase terms, and bundle their products in a manner that would put us at a competitive disadvantage.

Competition could materially and adversely affect our ability to obtain revenues from license fees from new or existing customers and professional services revenues from existing customers. Further, competitive pressures could require us to reduce the price of our software products. In either case, our business, operating results and financial condition would be materially and adversely affected.

PROPRIETARY RIGHTS AND LICENSING

Our success and ability to compete depend 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 trademark, trade secret and copyright law and contractual restrictions to protect our proprietary technology. These legal protections afford only limited protection for our technology. We seek to protect our source code for

our software, documentation and other written materials under trade secret and copyright laws. We license our software pursuant to signed license, "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.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult and while we are unable to determine the extent to which piracy of our software exists, software piracy can be expected to be a persistent problem. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity. However, the laws of many countries do not protect proprietary rights to as great an extent as the laws of the United States. Any such resulting litigation could result in substantial costs and diversion of resources and could have a material adverse effect on our business, operating results and financial condition. There can be no assurance that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology. Any failure by us to meaningfully protect our property could have a material adverse effect on our business, operating results and financial condition.

In addition, our software is written in the Java programming language developed by Sun Microsystems and we incorporate J2EE, Java Runtime Environment, Java Naming and Directory Interface, Java Servlet Development Kit, Java Foundation Classes, JavaMail and JavaBeans Activation Framework into our products under licenses granted to us by Sun. Our Dynamo 5 e -Business Platform has been designed to support Sun's J2EE standards. If Sun were to decline to continue to allow us to use these technologies for any reason, we would be required to (a) license the equivalent technology from another source, (b) rewrite the technology ourselves, or (c) rewrite portions of our software to accommodate the change or no longer use the technology.

EMPLOYEES

As of December 31, 2000, we had a total of 943 employees. Of our employees, 176 were in research and development, 324 in sales and marketing, 309 in professional services and 134 in finance and administration. Our future success will depend in part on our ability to attract, retain and motivate highly qualified technical and management personnel, for whom competition is intense. From time to time, we also employ independent contractors to support our professional services, product development, sales, marketing and business development organizations. 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.

FACTORS THAT MAY AFFECT OUR OPERATING RESULTS AND STOCK PRICE

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

RISKS RELATED TO OUR BUSINESS

WE DO NOT BELIEVE WE WILL BE ABLE TO SUSTAIN OUR CURRENT REVENUE GROWTH RATE, AND WE CANNOT BE CERTAIN THAT WE WILL BE ABLE TO SUSTAIN OR INCREASE PROFITABILITY ON A QUARTERLY OR ANNUAL BASIS.

The second, third and fourth quarters of 2000 were our first profitable quarters since inception. We have incurred substantial costs to develop and enhance our technology and products, to recruit and train a marketing and sales group, and to establish an administrative organization. As of December 31, 2000, we had an accumulated deficit of $14.4 million. We anticipate that our operating expenses will increase as we continue to develop our technology, increase our sales and marketing activities, create and expand our distribution channels, expand our services capabilities and improve our operational and financial systems. Although our revenues have grown significantly in recent quarters, they have grown from a relatively small base and, as a result, we do not believe that we will be able to sustain the growth rates we have achieved in recent quarters. In addition, we believe the current United States economic downturn will have an adverse effect on demand for our products and services, and therefore adversely affect our revenues as well. Because we have a limited operating history, particularly as a company that sells software products, we have difficulty predicting our future operating results and we cannot be certain that our revenues will grow at a rate that will allow us to maintain profitability. In addition, we cannot be certain that we will be able to sustain or increase profitability on a quarterly or annual basis.

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

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

- demand for our products and services;
- the timing of sales of our products and services;
- the timing of customer orders and product implementations;
- unexpected delays in introducing new products and services;
- increased expenses, whether related to sales and marketing, product development or administration;
- changes in the rapidly evolving market for Internet customer relationship management solutions;
- the mix of revenues derived from products and services;
- timing of hiring and utilization of services personnel;
- cost overruns related to fixed-price services projects;
- the mix of domestic and international sales; and
- costs related to possible acquisitions of technologies or

businesses.

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

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

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

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

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

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

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

The market for Internet customer relationship management solutions is intensely competitive and we expect competition to intensify in the future as revenues generated from Internet commerce increase. This level of competition could reduce our revenues and result in increased losses or reduced profits. Our primary competition currently comes from in-house development efforts by potential customers or partners, as well as from other vendors of Web-based application software. We currently compete with Internet application software vendors such as Blue Martini, BroadVision and Vignette. We also compete with platform application server products and vendors such as BEA Systems, IBM's Websphere products, Microsoft, and the Netscape/Sun Microsystems Alliance, among others. Many of our competitors have longer operating histories and significantly greater financial, technical, marketing and other resources than we do, and may be able to respond more quickly to new or changing opportunities, technologies and customer requirements. Also, many current and potential competitors have greater name recognition and more extensive

customer bases that they can 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.

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

We have expanded our operations rapidly in recent years. We intend to continue to expand in the foreseeable future to pursue existing and potential market opportunities and to support our growing customer base. The number of our employees increased from 324 on January 1, 2000 to 943 on December 31, 2000. Rapid growth places a significant demand on our management and operational resources. In order to manage growth effectively, we must implement and improve our operational systems, procedures and controls on a timely basis. We plan in particular to expand our professional services capabilities to support increased product license sales. However, we cannot be certain that we will be able to attract a sufficient number of highly qualified service personnel. In addition, new service personnel will require training and it will take time for them to become productive. If we fail to improve our operational systems or to expand our professional service capabilities in a timely manner, we could experience customer dissatisfaction, cost inefficiencies and lost revenue opportunities, which could harm our operating results.

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

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

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

Our success depends largely on the skills, experience and performance of some key members of our management, particularly our co-founders Jeet Singh and Joseph Chung. If we lose one or more of our key employees, our business could be harmed. We have purchased, and are the beneficiaries of, insurance

policies on the lives of Mr. Singh and Mr. Chung, each in the amount of $1,000,000. Proceeds under this insurance may not cover our losses. In addition, our future success will depend in large part on our ability to continue attracting and retaining highly skilled personnel. Like other software companies, we face intense competition for qualified personnel. We may not be successful in attracting, assimilating and retaining qualified personnel in the future.

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

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

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

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

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

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. We could incur substantial costs to prosecute or defend any intellectual property litigation. If we sue to enforce our rights, the litigation would be expensive, would divert management resources and may not prevent 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 $11 million had been paid as of December 31, 2000.

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

- cease selling or using products or services that incorporate the challenged intellectual property;

- obtain a license, which may not be available on reasonable terms, to sell or use the relevant technology; or

- redesign those products or services to avoid infringement.

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

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

development and testing periods. Any delays in developing and releasing 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 have recently begun to invest significant financial and managerial resources to expand our sales and marketing operations in international markets. We currently maintain offices in Australia, Canada, England, France, Germany, Hong Kong, Japan, the Netherlands, Singapore and Sweden. We derived 21% of our total revenues from customers outside North America for the year ended December 31, 2000. We anticipate that revenues from customers outside North America will account for an increased portion of our total revenues for the foreseeable future. To date, however, we have limited experience in international operations and may not be able to compete successfully in international markets. Our operations outside North America are subject to additional risks, including:

- unexpected changes in regulatory requirements, exchange rates, tariffs and other barriers;

- longer payment cycles and problems in collecting accounts receivable;

- political and economic instability;

- difficulties in managing system integrators and technology partners;

- difficulties in staffing and managing foreign subsidiary operations;

- differing technology standards;

- difficulties and delays in translating products and product documentation into foreign languages;

- reduced protection for intellectual property rights in some of the countries in which we operate or plan to operate;

- problems associated with the conversion of various European currencies into a single currency, the euro; and

- potentially adverse tax consequences.

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

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

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

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

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

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

IF WE ACQUIRE OTHER COMPANIES OR BUSINESSES, WE WILL BE SUBJECT TO RISKS THAT

COULD HURT OUR BUSINESS.

We acquired Petronio Technology Group in May 2000 for consideration of approximately $1.2 million and The Toronto Technology Group in July 2000 for consideration of approximately $12.0 million. In the future, we may pursue additional acquisitions to obtain complementary businesses, products, services or technologies. An acquisition may not produce the revenues, earnings or business synergies that we anticipated, and an acquired business, product, service or technology might not perform as we expected. If we pursue an acquisition, our management could spend a significant amount of time and effort in identifying and completing the acquisition. If we complete an acquisition, we may encounter significant difficulties and incur substantial 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. Finally, if we are unable to account for our acquisitions under the "pooling-of-interests" method of accounting, which may be eliminated, we may be required to capitalize a significant amount of intangibles, including goodwill, which may lead to significant amortization charges. In addition, we may incur significant, one-time write-offs and amortization charges. These amortization charges and write-offs could decrease our future earnings or increase our future losses.

RISKS RELATED TO THE INTERNET INDUSTRY

OUR PERFORMANCE WILL DEPEND ON THE GROWTH OF E-COMMERCE.

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

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

As e-commerce evolves, federal, state and foreign agencies could adopt regulations covering issues such as user privacy, content and taxation of products and services. If enacted, government regulations could limit the market for our products and services or could impose burdensome requirements

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

THE INTERNET IS GENERATING PRIVACY CONCERNS 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 Dynamo Personalization Server product to develop and maintain profiles to tailor the content to be provided to Web site visitors. When a visitor first arrives at a Web site, our software creates a profile for that visitor. If the visitor registers or logs in, the visitor's identity is added to the profile, preserving any profile information that was gathered up to that point. Dynamo Personalization Server tracks both explicit user profile data supplied by the user as well as implicit profile attributes derived from the user's behavior on the Web site. Privacy concerns may cause visitors to resist providing the personal data or avoid Web sites tracking the Web behavioral information necessary to support this profiling capability. More importantly, even the perception of security and privacy concerns, whether or not valid, may indirectly inhibit market acceptance of our products. In addition, legislative or regulatory requirements may heighten these concerns if businesses must notify Web site users that the data captured after visiting Web sites may be used to direct product

promotion and advertising to that user. Other countries and political entities, such as the European Economic Community, have adopted such legislation or regulatory requirements. The United States may adopt similar legislation or regulatory requirements. If privacy legislation is enacted or consumer privacy concerns are not adequately addressed, our business, financial condition and operating results could be harmed.

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

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

This annual report contains various data and projections related to revenues generated by electronic commerce and the size of the worldwide Internet

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

RISKS RELATED TO THE SECURITIES 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 $5.13 per share to $126.88 per share since our initial public offering in July 1999. Fluctuations in market price and volume are particularly common among securities of Internet and software companies. The market price of our common stock may fluctuate significantly in response to the following factors, some of which are beyond our control:

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

WE MAY INCUR SIGNIFICANT COSTS FROM CLASS ACTION LITIGATION.

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

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

Our executive officers and directors beneficially owned approximately 20% of our common stock as of February 28, 2001. As a result, these stockholders may be able to influence matters requiring stockholder approval, including the

election of directors and approval of significant corporate transactions. This could delay or prevent someone from acquiring or merging with us.

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

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

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

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

Item 2. PROPERTIES

Our headquarters are currently located in a leased facility in Cambridge, Massachusetts, consisting of approximately 60,000 square feet. In August 2000 we entered into a lease for approximately 30,000 square feet in another facility in Cambridge, Massachusetts, and in June 2000 we entered into a lease for approximately 42,000 square feet in Waltham, Massachusetts. We also have offices for sales and support personnel in eight additional domestic locations as well as in ten foreign countries.

Item 3. LEGAL PROCEEDINGS

A patent infringement claim was filed by BroadVision, one of our competitors, against us on December 11, 1998. The case was filed in the U.S. District Court for the Northern District of California. BroadVision alleged that we are

infringing on a patent for a method of conducting e-commerce. We settled the lawsuit in February 2000. 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 over a three-year period.

On October 31, 2000, Aron Rosenberg, one of our stockholders, filed a lawsuit in the United States District Court for the District of Delaware, ROSENBERG V. TUDOR INVESTMENT CORP., TUDOR PRIVATE EQUITY FUND L.P., THE RAPTOR GLOBAL FUND L.P., THE RAPTOR GLOBAL FUND LTD., TUDOR GLOBAL TRADING LLC AND ART TECHNOLOGY GROUP, INC., Civil Action No. 00-925. Mr. Rosenberg's complaint alleges that the Tudor and Raptor entities violated Section 16(b) of the Securities Exchange Act of 1934 in connection with their sales of our common stock after our initial

public offering on July 20, 1999. Those entities received shares of our common stock immediately before our closing of our initial public offering, upon the conversion of Series D preferred stock that they had acquired more than six months before our initial public offering. The complaint alleges that those entities should be deemed to have purchased shares of our common stock shortly before the closing of our initial public offering, as the result of changes effected through a charter amendment relating to the preferred stock. The complaint also alleges that the entities obtained profits of more than $70 million from sales of our common stock within six months after the date on which such purchase should be deemed to have occurred and that those profits should be paid to our company in accordance with Section 16(b). Although we are a nominal defendant in the suit, Mr. Rosenberg is not seeking any damages from us. We cannot assure you that we will receive any payment as a result of this lawsuit.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock began trading on the Nasdaq National Market under the symbol "ARTG" on July 21, 1999. Prior to that time, there was no established public trading market for our common stock. The following table sets forth the high and low reported sales prices of our common stock for the periods indicated as reported by the Nasdaq National Market.

	HIGH	LOW
Year ending December 31, 1999		
Third quarter (commencing July 21, 1999)	$ 19.06	$ 5.13
Fourth quarter	66.00	17.56
Year ending December 31, 2000		
First quarter	106.50	43.81
Second quarter	101.94	28.63
Third quarter	126.88	76.00
Fourth quarter	96.50	20.50

On March 26, 2001 the last reported sale price on the Nasdaq National Market for our common stock was $20.00 per share. On March 26, 2001, there were 16,740 holders of record of our common stock.

We currently intend to retain future earnings, if any, to finance our growth. We do not anticipate paying cash dividends on our common stock in the foreseeable future. Payment of future dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, restrictions in financing agreements and plans for expansion.

On July 26, 1999, we completed our initial public offering of 10,000,000 shares of common stock at a public offering price of $6.00 per share (SEC registration number 333-78333). Our net proceeds from the offering were approximately $54,302,000. On July 30, 1999, in connection with the exercise of the underwriters' over-allotment option, we issued an additional 336,000 shares of common stock at the initial public offering price of $6.00 per share. Our net proceeds from the exercise of the over-allotment option were approximately $1,875,000. In connection with our initial public offering in

July 1999, all shares of our preferred stock were converted into 31,419,278 shares of common stock.

On November 10, 1999, we completed a follow-on public offering of 9,000,000 shares of common stock, of which 2,850,000 shares were sold by us at a public offering price of $33.75 (SEC registration number 333-89577). Our net proceeds from the offering were approximately $91,428,000. On November 22, 1999, in connection with the exercies of the underwriters' over-allotment option, we issued an additional 175,840 shares of common stock at the public offering price of $33.75 per share. Our net proceeds from the exercise of the over-allotment option were approximately $5,671,000.

Through December 31, 2000, we used approximately $84.1 million of our proceeds from the public offerings for sales and marketing, approximately $27.9 million for capital expenditures, approximately $22.3 million for research development, and approximately $500,000 for the repayment of indebtedness. Additionally, we paid $5.2 million as partial consideration and for professional fees in connection with our acquisition of The Toronto Technology Group Inc. in July 2000. As of December 31, 2000, we had approximately $12.8 million of net proceeds remaining, and pending use of these proceeds, we intend to invest these net proceeds primarily in high-quality short-term investments.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data set forth below as of December 31, 1999 and 2000 and for each of the years ended December 31, 1998, 1999 and 2000 are derived from consolidated financial statements audited by Arthur Andersen LLP, independent public accountants, which are included in this annual report. The selected consolidated financial data as of December 31, 1996, 1997 and 1998 and for each of the years ended December 31, 1996 and 1997 are derived from audited consolidated financial statements not included in this annual report. Additional information regarding basic and diluted net income (loss) per share is described in note 1(e) to the consolidated financial statements included elsewhere in this annual report. The following data should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this annual report and with "Management's Discussion and Analysis of Financial Condition and Results of Operations."

CONSOLIDATED STATEMENTS OF OPERATIONS DATA:

	Year Ended December 31			
	1996	1997	1998	
	(in thousands, except per shar			
Revenues:				
Product license	$ 53	$1,866	$4,059	$1
Services	3,849	4,592	8,078	1
Total revenues	3,902	6,458	12,137	3
Cost of Revenues:				
Product license	--	64	30	

Services	1,985	3,133	5,020	1
Total cost of revenues	1,985	3,197	5,050	1
Gross profit	1,917	3,261	7,087	
Operating Expenses:				
Research and development	1,117	3,661	3,355	
Sales and marketing	1,152	2,287	4,074	
General and administrative	1,060	1,418	2,291	
Amortization of deferred compensation	--	--	107	
Total operating expenses	3,329	7,366	9,827	
Income (Loss) from Operations	(1,412)	(4,105)	(2,740)	(
Interest income	--	6	54	
Interest expense	(30)	(129)	(165)	
Net income (loss) before provision for income taxes	(1,442)	(4,228)	(2,851)	(
Provision for income taxes	--	--	--	
Net income (loss)	(1,442)	(4,228)	(2,851)	(
Accretion of Dividends, Discount and Offering Costs on Preferred Stock	(206)	(214)	(1,594)	
Net income (loss) available for common stockholders	$(1,648)	$ (4,442)	$(4,445)	$(
Net income (loss) per share:				
Basic	$ (0.09)	$ (0.25)	$ (0.25)	$
Diluted	$ (0.09)	$ (0.25)	$ (0.25)	$
Weighted average common shares outstanding:				
Basic	17,698	17,744	17,394	
Diluted	17,698	17,744	17,394	

CONSOLIDATED BALANCE SHEET DATA (at period end):	1996	1997	1998	1
Cash, cash equivalents and short term marketable securities	$2,358	$ 187	$ 4,093	$12
Working capital (deficit)	902	(1,328)	3,649	11
Long-term marketable securities	--	--	--	1
Total assets	3,038	1,672	7,766	17
Long-term obligations, less current maturities	24	122	322	
Redeemable convertible preferred stock	3,000	3,153	8,313	
Total stockholders' equity (deficit)	(1,648)	(4,060)	(4,034)	14

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS

OF OPERATIONS

Overview

THE FOLLOWING DISCUSSION AND ANALYSIS OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES APPEARING ELSEWHERE IN THIS ANNUAL 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 UNDER "ITEM 1. BUSINESS--FACTORS THAT MAY AFFECT OUR OPERATING RESULTS AND STOCK PRICE" AND ELSEWHERE IN THIS ANNUAL 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 Dynamo Application Server product and have completed development of our current product suite. We began shipping the commercial version of Dynamo 5 e -Business Platform in September 2000. We market and sell our products worldwide through our direct sales force, systems integrators, technology partners and original equipment manufacturers.

We derive our revenues from the sale of software product licenses and related services. Product license revenues are derived from the sale of software licenses of our Dynamo products. Our software licenses are priced based on either the size of the customer implementation or site license terms. Services revenues are derived from fees for professional services, training and software maintenance and support. Professional services include custom application development and project and technical consulting. We bill professional service fees primarily on a time and materials basis or in some cases, on a fixed-price schedule defined specifically in our contracts. Software maintenance and support arrangements are priced based on the level of services provided. Generally, customers are entitled to receive software updates, maintenance releases and technical support for an annual maintenance fee of 20% to 30% of the list price of the licensed product. Customers that purchase maintenance and support generally receive all product updates and upgrades of software modules purchased as well as Web-based and telephone technical support. Training is billed as services are provided.

We recognize revenue in accordance with Statement of Position (SOP) 97-2, SOFTWARE REVENUE RECOGNITION and SOP 98-9, MODIFICATION OF SOP 97-2, SOFTWARE REVENUE RECOGNITION, WITH RESPECT TO CERTAIN TRANSACTIONS. Revenues from software product license agreements are recognized upon execution of a license agreement and delivery of the software, provided that the fee is fixed or determinable and deemed collectible by management. If conditions for acceptance are required subsequent to delivery, revenues are recognized upon customer acceptance if such acceptance is not deemed to be perfunctory. In multiple element arrangements, we use the residual value method in accordance with SOP 97-2 and SOP 98-9. Revenues from software maintenance agreements are recognized ratably over the term of the maintenance period, which is typically one year. We enter into reseller arrangements that typically provide for sublicense fees payable to us based upon a percentage of our list price. Revenues are recognized under reseller agreements as earned which is generally ratably over the life of the reseller agreement for guaranteed minimum royalties or based upon unit 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.

Services revenues have increased primarily due to the expansion of our service capabilities by hiring additional service personnel and the increase in the number of customers using our Dynamo products. Sales of Dynamo products often lead to sales of consulting services and software maintenance and support. To date, substantially all of our Dynamo customers have entered into annual software maintenance and support agreements at the time of purchase and have renewed such maintenance and support contracts in subsequent periods. We believe that growth of our product license sales depends on our ability to provide customers with support, training, consulting and implementation services and to educate systems integrators and resellers on how to use and install our products. We have invested significantly and expect to continue to invest in expanding our services organization.

We have recently begun to invest significant financial and managerial resources to expand our sales and marketing operations in international markets. We currently maintain offices in Australia, Canada, England, France, Germany, Hong Kong, Japan, the Netherlands, Singapore and Sweden. Revenues from customers outside the United States accounted for 7% of our total revenues in 1998, 7% in 1999 and 23% in 2000. We have not entered into contracts denominated in foreign currencies to date, but may in the future. We currently do not have hedging or similar arrangements to protect us against foreign currency fluctuations. We, therefore, increasingly may become subject to currency fluctuations, which could harm our operating results in future periods.

RESULTS OF OPERATIONS

The following table sets forth statement of operations data as percentages of total revenues for the periods indicated:

	YEAR ENDED DECEMBER 31,		
	1998	1999	2000
Revenues:			
Product license	33%	58%	74%
Services	67	42	26
Total revenues	100	100	100
Total cost of revenues	42	57	23
Gross margin	58	43	77
Operating expenses:			
Research and development	27	20	12
Sales and marketing	34	50	45

General and administrative	19	17	14
Stock-based compensation	1	3	1
Total operating expenses	81	90	72
Income (loss) from operations	(23)	(47)	5
Interest income (expense), net	(1)	6	6
Income (loss) before provision for income taxes	(24)	(41)	11
Provision for income taxes	--	--	2
Net income (loss)	(24)%	(41)%	9%

The following table sets forth, for the periods indicated, 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:

	YEAR ENDED DECEMBER 31,		
	1998	1999	2000
Cost of product license revenues	1%	44%	3%
Cost of services revenues	62	76	83

YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

REVENUES

Total revenues increased 409% from $32.1 million in 1999 to $163.3 million in 2000. The increase was primarily attributable to market acceptance of our Dynamo suite of products as we continued to cultivate relationships with systems integrators and train our partner channels to encourage them to support our products. Additionally, global expansion and the release of our newest product offering in September 2000, ATG Dynamo 5, contributed to our revenue growth. Revenues generated from international customers increased to $37.6 million in 2000 from $2.2 million in 1999.

Total revenues increased 164% from $12.1 million in 1998 to $32.1 million in 1999. The increase was primarily attributable to growth in the number of customers and the number of larger deals with customers. In addition, we expanded our sales force and introduced version 4.0 of our Dynamo product suite in December 1998, which increased our market presence.

No individual customer accounted for more than 10% of total revenues in 1999 or 2000. In 1998, three customers each accounted for more than 10% of total revenues and collectively accounted for 37% of total revenues.

PRODUCT LICENSE REVENUES

Product license revenues increased 553% from $18.6 million in 1999 to $121.5 million in 2000. The increase was primarily attributable to the continued

rapid growth in our partner channel, as well as increased sales to larger enterprises and international customers. Product license revenues generated from international customers increased to $27.1 million in 2000 from $1.2 million in 1999. We experienced an increase in the number of individual license arrangements under which the initial license fee was in excess of $1 million. Additionally, the increase was attributable to the market acceptance of ATG Dynamo 5, which was released in September 2000. We anticipate that product license revenues will continue to grow in absolute dollars, but expect the sequential rate of growth to decrease as compared to the past several quarters.

Product license revenues increased 358% from $4.1 million in 1998 to $18.6 million in 1999. This increase was attributable to the market acceptance of our Dynamo product suite following the release of Dynamo 4.0 in December 1998 and an increase in the number of larger deals with customers. Additionally, 11% of our product license revenues in 1999 were the result of an agreement with an original equipment manufacturer or OEM. The OEM agreement had an initial term that ended on December 31, 2000. We elected not to renew the agreement.

Product license revenues as a percentage of total revenues for the years ended December 31, 2000, 1999 and 1998 were 74%, 58% and 33%, respectively. We expect this percentage to decrease in the foreseeable future until reaching a level of approximately two-thirds of total revenues.

SERVICES REVENUES

Services revenues increased 210% from $13.5 million in 1999 to $41.8 million in 2000. Professional services revenues increased 95% from $9.7 million in 1999 to $18.9 million in 2000. The increase in professional services revenues was primarily attributable to the continued growth of our customer base and an increase in resources in our professional services group including the acquisition of The Toronto Technology Group, Inc. Software maintenance and support revenues increased 496% from $2.8 million in 1999 to $16.7 million in 2000. The increase in software maintenance and support revenues was the result of continued increases in product revenues that generate software maintenance and support revenues and increases in software maintenance and support renewals. Training revenues increased 463% from $1.1 million in 1999 to $6.2 million in 2000. The increase in training revenues was primarily attributable to our extended training program offerings. Additionally, our acquisition of Petronio Technology Group on May 17, 2000 provided us with additional Java, J2EE and XML courseware, as well as strengthened our training capabilities with the addition of seasoned trainers and curriculum developers. We believe these capabilities enhance our selling efforts for product license revenues to end-users, resellers and partners. We anticipate that services revenues will continue to grow in absolute dollars, but expect the sequential rate of growth to decrease as compared to the past several quarters.

Services revenues increased 67% from $8.1 million in 1998 to $13.5 million in 1999. Professional services revenues increased 26% in 1999 from $7.7 million in 1998 to $9.7 million in 1999. The increase in professional services revenues was primarily attributable to the continued growth of our customer base and an increase in resources in our professional services group. Software maintenance and support revenues increased 653% from $372,000 in 1998 to $2.8 million in 1999. This increase in software maintenance and support revenues was attributable to an increase in the number of customers and sales of product licenses.

Services revenues as a percentage of total revenues for the years ended December 31, 2000, 1999 and 1998 were 26%, 42% and 67%, respectively. We expect this percentage to increase in the forseeable future to approximately

one-third of total revenues.

COST OF PRODUCT LICENSE REVENUES

Cost of product license revenues decreased from $8.2 million in 1999 to $3.4 million in 2000. For the year ended December 31, 2000, approximately $2.3 million related to the BroadVision settlement which was included in cost of product license revenues. We paid BroadVision $750,000 per quarter in 2000 and will pay BroadVision $500,000 per quarter in 2001 and 2002. Cost of product license revenues also includes costs associated with sustaining the current release of the Dynamo suite of products.

Cost of product license revenues increased from $30,000 in 1998 to $8.2 million in 1999. 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 $8.0 million in February 2000 was expensed during the year ended December 31, 1999, and the remaining $7.0 million is being expensed ratably over a three-year period that began in the first quarter of 2000.

COST OF SERVICES REVENUES

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

Cost of services revenues increased 240% from $10.2 million in 1999 to $34.7 million in 2000. The increase was attributable to the growth of our resources in our professional services group. Approximately 61% of the increase was related to compensation and benefit costs. Additionally, costs increased due to travel, recruiting, hiring and training.

Cost of services revenues increased 104% from $5.0 million in 1998 to $10.2 million in 1999. The increase was attributable to the increase in resources in our professional services group. Approximately 86% of the increase was attributable to increased compensation costs for continued increases in head count. Further, increased costs resulted from establishing a training organization and the introduction of training programs in December 1998. Additionally, costs increased due to travel, recruiting and facilities costs.

RESEARCH AND DEVELOPMENT EXPENSES

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

Research and development expenses increased 199% from $6.3 million in 1999 to $19.0 million in 2000. The increase was due principally to the research and development expenses associated with our Dynamo 5 e-Business Platform, which

we announced in July 2000 and began shipping in September 2000. Approximately 73% of the increase was related to compensation and benefit costs. Additionally, costs increased due to travel, recruiting, hiring and training.

Research and development expenses increased 89% from $3.4 million in 1998 to $6.3 million in 1999. Approximately 79% of the increase was due to growth in hiring engineers into the group and related costs including salaries and related benefits. The remainder of the increase was primarily due to increased facilities costs.

For the years ended December 31, 2000, 1999 and 1998, research and development expenses as a percentage of total revenues were 12%, 20% and 27%, respectively. The percentage decrease principally reflected growth in the level of our total revenues. We expect that research and development expenses, in absolute dollars, will increase as we expand our research and development hiring efforts subsequent to the Dynamo 5 general release. We expect that research and development expenses will represent a greater percentage of total revenues in 2001 than in 2000. We anticipate, however, that research and development expenses will fluctuate as a percentage of total revenues based upon the level of revenue growth.

SALES AND MARKETING EXPENSES

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

Sales and marketing expenses increased 360% from $15.9 million in 1999 to $73.3 million in 2000. The increase was associated primarily with international sales and marketing expansion, global hiring, advertising efforts, branding and increased commissions. Approximately 47% of the increase was related to compensation and benefit costs, and 28% of the increase was related to marketing and promotional expenses. Additionally, costs increased due to travel, recruiting, hiring and training.

Sales and marketing expenses increased 291% from $4.1 million in 1998 to $15.9 million in 1999. Approximately 44% of the increase was due to a significant increase in the number of sales and marketing personnel and related expenses, and 29% of the increase was related to new and increased marketing program expenditures.

For the years ended December 31, 2000, 1999 and 1998, sales and marketing expenses as a percentage of total revenues were 45%, 50% and 34%, respectively. We expect that sales and marketing expenses will increase in absolute dollars as we continue to execute our strategy for expansion of our sales and marketing efforts, both domestically and internationally. We will continue to hire and train new sales personnel, open additional sales offices, increase marketing and promotional spending and execute our global branding initiatives. We expect that sales and marketing expenses will represent a smaller percentage of total revenues in the next year than in 2000. We anticipate, however, that sales and marketing expenses will fluctuate as a percentage of total revenues depending on the level and timing of global expansion, program spending, the rate at which newly hired sales personnel become productive and the level of revenue 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 increased 328% from $5.3 million in 1999 to $22.8 million in 2000. Approximately 48% of the increase was related to increases in personnel and related expenses, driven by expansion both domestically and internationally. Approximately 13% of the increase was related to an increase in consultant expenses. Additionally, the increase was the result of recording additional allowances for doubtful accounts as a result of the significant increases in revenues and the potential for a slowdown in the economy.

General and administrative expenses increased 132% from $2.3 million in 1998 to $5.3 million in 1999. Approximately 30% of the increase was related to the hiring of additional professionals to manage the growth of the company resulting in increased salaries and benefits. Approximately 19% of the increase was due to increased consulting services and approximately 13% of the increase was due to costs related to hiring and training new personnel.

For the years ended December 31, 2000, 1999 and 1998, general and administrative expenses as a percentage of total revenues were 14%, 17% and 19%, respectively. We plan to continue investing in infrastructure and personnel to help support our planned growth. As a result, we expect an increase, in absolute dollars, in general and administrative costs for the next year. We expect that general and administrative expenses will represent a smaller percentage of total revenues in the foreseeable future than in 2000. We anticipate, however, that general and administrative

expenses will fluctuate as a percentage of total revenues depending upon the rate of growth in expenditures and total revenues.

STOCK-BASED COMPENSATION

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

Stock-based compensation expense increased 18% from $1.1 million in 1999 to $1.3 million in 2000. This increase was due to the timing of our recording of stock-based compensation and the options acquired in connection with the acquisition of The Toronto Technology Group, Inc. We expect stock-based compensation expense to increase to approximately $1.5 million in 2001.

Stock-based compensation expense increased 953% from $107,000 in 1998 to $1.1 million in 1999. This was due to the timing of our recording of stock-based compensation.

INTEREST INCOME (EXPENSE)

Interest income increased 350% from $2.0 million in 1999 to $9.0 million in 2000. The increase is primarily the result of the completion of our initial public offering in July 1999 and a follow-on public offering in November 1999, from which we received net proceeds of approximately $153.3 million that we invested primarily in cash, cash equivalents and marketable securities. Additionally, the positive cash flow from operations has

contributed to the increase in interest income.

Interest expense decreased from $121,000 in 1999 to zero in 2000. The decrease was related to the repayment of outstanding indebtedness in 1999 with the proceeds from our initial public offering.

Interest income increased from $54,000 in 1998 to $2.0 million in 1999. The increase was the result of the completion of our initial and follow-on public offerings completed in July and November 1999, from which we received net proceeds of approximately $153.3 million that was invested primarily in cash, cash equivalents and marketable securities.

Interest expense decreased 27% from $165,000 in 1998 to $121,000 in 1999. The decrease was primarily related to the repayment of outstanding indebtedness with the proceeds from our initial public offering.

PROVISION FOR INCOME TAXES

As a result of achieving profitability in 2000, we recorded a provision for income taxes of $3.4 million, which represents an effective tax rate of 18.9%. Our effective tax rate for 2000 was below the statutory rate due primarily to the utilization of net operating loss carryforwards. As of December 31, 2000, all net operating loss carryforwards have been benefited for financial reporting purposes. We expect our effective tax rate for 2001 to be approximately 40%. We incurred losses in 1998 and 1999. Accordingly, there was no provision for income taxes for these periods.

LIQUIDITY AND CAPITAL RESOURCES

Our capital requirements relate primarily to facilities, infrastructure for new hires and working capital requirements. Historically, we have funded our cash requirements primarily through the public and private sale of equity securities, commercial credit facilities and capital leases. In 2000, we began to fund our cash requirements in part from operations. At February 28, 2001, we had $51.5 million in cash and cash equivalents and $65.8 million in marketable securities.

Cash provided by operating activities was $18.3 million in 2000. This consisted of operating income of $14.5 million and changes in working capital including cash provided by increases in accrued expenses of $24.7 million and deferred revenue of $14.4 million offset by cash used to fund an increase in accounts receivable was $39.9 million. Cash used in operating activities was $2.0 million for 1999. This represented an operating loss of $13.1 million and changes in working capital items consisting primarily of cash provided by deferred revenue, accounts payable and accrued expenses, including the $8.0 million license fee which was paid to BroadVision in February 2000. The cash provided by the change in deferred revenue was primarily the result of $5.0 million we received from an original equipment manufacturer, of which $2.9 million was included in deferred revenue as of December 31, 1999.

Our investing activities for the year ended December 31, 2000 consisted primarily of capital expenditures of $21.7 million, net purchases of marketable securities of $66.4 million and the purchase of The Toronto Technology Group, Inc. and Petronio Technology Group which utilized a total of $5.8 million of cash. In the second quarter of 2000 we acquired Petronio Technology Group and, pursuant to the acquisition agreement, made an initial cash payment of $600,000 and may be obligated to make two additional contingent payments of $300,000 each. In addition, in July 2000 we acquired The Toronto Technology Group for $12.0 million in cash, options and exchangeable shares of common stock. We paid $5.2 million in cash upon the

closing of this acquisition and will pay the remainder of the purchase price in options and exchangeable shares through 2003. To support growth in headcount and global expansion, assets acquired both in 1999 and 2000 consisted principally of leasehold improvements, computer hardware and software. We expect that our capital expenditures will continue to increase significantly as our employee base grows. We expect that capital expenditures will total approximately $45.0 million over the next twelve months. Our investing activities in 1999 consisted primarily of capital expenditures of $5.6 million and increases in other assets for facilities deposits and similar items of $690,000, in addition to the net purchase of marketable securities of $24.5 million.

We have a revolving line of credit with Silicon Valley Bank, which provides for borrowings of up to the lesser of $12.5 million or 80% of eligible accounts receivable. The line of credit bears interest at the bank's prime rate (8.5% at February 28, 2001). At February 28, 2001, we had approximately $4.1 million available under the line of credit based upon our borrowing base, no outstanding borrowings and $8.4 million of outstanding letters of credit which apply against our availability. The line of credit is secured by all of our tangible and intangible intellectual and personal property and is subject to financial covenants and restrictions, including minimum liquidity requirements and a prohibition on the payment of dividends. We currently are in compliance with all related financial covenants and restrictions. We are negotiating with Silicon Valley Bank to increase the aggregate amount available under this facility from $12.5 million to $25.0 million.

In September 2000, we entered into a non-recourse receivables purchase agreement with Silicon Valley Bank, under which we can sell up to $10.0 million of our accounts receivable to the bank. Under the terms of the receivables purchase agreement, we can sell certain accounts receivable, subject to acceptance by the bank, on a non-recourse basis. Upon purchase, the bank assumes the risk of collection for the acquired accounts receivable except in the event we violate the terms of the receivables purchase agreement or the customer asserts a discount, allowance, warranty claim or right of return. The accounts receivable are sold at a discount to reflect a minimum of 45 days and a maximum of 135 days at the bank's prime rate plus 1%. This agreement will expire in September 2001. During the year ended December 31, 2000, we sold $9.6 million of accounts receivable to the bank under the receivables purchase agreement. As of February 28, 2001, all of the sold receivables have been collected. For the year ended December 31, 2000, we incurred approximately $166,000 in expenses related to this transaction.

Net cash provided by financing activities was $3.6 million in 2000, principally representing proceeds from stock option exercises and the employee stock purchase plan, offset in part by payments on long-term obligations to Broadvision. Net cash provided by financing activities was $153.4 million for 1999, primarily resulting from the net proceeds from our initial and follow-on public offerings, which generated $153.3 million.

We believe that with our existing financial resources and commercial credit facilities together with cash generated by our operations, will be able to meet our cash requirements for at least the next twelve months.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2000, the Financial Accounting Standards Board (FASB) issued SFAS No. 140, ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENT OF LIABILITIES, which supercedes SFAS No. 125. SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 is

effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001 and for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. The Company does not expect the adoption of SFAS No. 140 to have a material impact on the results of its consolidated financial position or results of operations.

In June 1998, the FASB issued SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. As amended in June 1999 by SFAS No. 137, the statement is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. In June 2000, the FASB issued SFAS No. 138, ACCOUNTING FOR CERTAIN DERIVATIVE INSTRUMENTS AND CERTAIN HEDGING ACTIVITIES which is a significant amendment to SFAS No. 133. SFAS No. 133 and its amendments establish accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. The Company does not expect the adoption of these statements to have a material impact on its consolidated financial position or results of operations.

Item 7a. 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 each of the three years ended December 31, 2000. We do not use derivative financial instruments for investment purposes and only invest in financial investments that meet high credit quality standards, as specified in our investment policy guidelines; the policy also limits the amount of credit exposure to any one issue, issuer, and type of instrument.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ART TECHNOLOGY GROUP, INC

Report of Independent Public Accountants

To the Stockholders and Board of Directors of
Art Technology Group, Inc.

We have audited the accompanying consolidated balance sheets of Art Technology Group, Inc. (a Delaware corporation) and subsidiaries as of December 31, 1999 and 2000 and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the acounting principles used and significant estimates made by management, as well as

evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Art Technology Group, Inc. and subsidiaries as of December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States.

/s/ Arthur Andersen LLP

Boston, Massachusetts
January 24, 2001

Art Technology Group, Inc. Consolidated Balance Sheets
(In thousands, except share and per share information)

	DECEMBER 31, 1999	DECEMBER 31, 2000
ASSETS		
Current Assets:		
Cash and cash equivalents	$124,711	$53,255
Marketable securities	5,137	73,218
Accounts receivable, net of reserves of approximately $460 and $2,655 at December 31, 1999 and 2000, respectively	12,539	52,440
Unbilled services	782	1,273
Prepaid expenses and other current assets	1,908	4,222
Deferred tax asset	-	3,556
Total current assets	145,077	187,964
Property and Equipment, Net	5,465	23,492
Long-Term Marketable Securities	19,394	17,734
Other Assets	7,799	13,246
Deferred Tax Asset	-	17,079
	$177,735	$259,515
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current maturities of long-term obligations	$ 3,000	$ 2,000
Accounts payable	11,285	11,375
Accrued expenses	4,728	29,402
Deferred revenue	8,337	22,765
Total current liabilities	27,350	65,542
Long-Term Obligations, Less Current Maturities	4,000	2,000

Commitments and Contingencies (Note 3 and 8)		
Stockholders' Equity:		
Preferred stock, $0.01 par value		
Authorized--10,000,000 shares		
Issued and outstanding--no shares	-	-
Common stock, $0.01 par value		
Authorized--100,000,000 shares and 500,000,000 shares at December 31, 1999 and 2000, respectively		
Issued and outstanding--65,551,024 shares and 67,894,357 shares at December 31, 1999 and 2000, respectively	656	679
Additional paid-in capital	178,218	209,338
Deferred compensation	(3,628)	(3,670)
Accumulated deficit	(28,861)	(14,374)
Total stockholders' equity	146,385	191,973
	$177,735	$259,515

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

Art Technology Group, Inc. Consolidated Statements of Operations
(In thousands, except per share information)

	YEAR ENDED DECEMBER 31,		
	1998	1999	2000
Revenues:			
Product license	$ 4,059	$18,590	$121,525
Services	8,078	13,487	41,817
Total revenues	12,137	32,077	163,342
Cost of Revenues:			
Product license	30	8,160	3,426
Services	5,020	10,232	34,739
Total cost of revenues	5,050	18,392	38,165
Gross profit	7,087	13,685	125,177
Operating Expenses:			
Research and development	3,355	6,343	18,966
Sales and marketing	4,074	15,921	73,261
General and administrative	2,291	5,323	22,791
Stock-based compensation	107	1,127	1,273
Total operating expenses	9,827	28,714	116,291

Income (loss) from operations	(2,740)	(15,029)	8,886
Interest Income	54	2,018	8,979
Interest Expense	(165)	(121)	--
Income (loss) before provision for income taxes	(2,851)	(13,132)	17,865
Provision for Income Taxes	--	--	3,378
Net income (loss)	(2,851)	(13,132)	14,487
Accretion of Dividends, Discount and Offering Costs on Preferred Stock	(1,594)	(4,395)	--
Net income (loss) available for common stockholders	$(4,445)	$(17,527)	$14,487
Net Income (Loss) Per Share:			
Basic	$ (0.25)	$(0.45)	$.22
Diluted	$ (0.25)	$(0.45)	$.20
Weighted Average Common Shares Outstanding:			
Basic	17,934	38,777	66,932
Diluted	17,934	38,777	73,138

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

ART TECHNOLOGY GROUP, INC. CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)

	SERIES A&C CONVERTIBLE PREFERRED STOCK		COMMON STOCK		
	NUMBER OF SHARES	CARRYING VALUE	NUMBER OF SHARES	$0.01 PAR VALUE	ADDI PAI CAP
Balance, December 31, 1997	2,509,875	$2,461	17,813,400	$178	
Sale of Series C convertible preferred stock	246,914	400	--	--	
Issuance costs related to sale of Series D redeemable convertible preferred stock	--	--	--	--	
Accretion of Series B and Series D redeemable convertible preferred stock to redemption value	--	--	--	--	
Exercise of stock options	--	--	442,710	5	

Deferred compensation related to stock option grants	--	--	--	--	1
Amortization of deferred compensation	--	--	--	--	
Warrants issued in connection with the sale of Series D redeemable convertible preferred stock	--	--	--	--	2
Issuance of Series B redeemable convertible preferred stock warrants	--	--	--	--	1
Grants of options to consultants (Note 6(b))	--	--	--	--	
Issuance of warrants (Note 3(d))	--	--	--	--	
Net loss	--	--	--	--	
Balance, December 31, 1998	2,756,789	2,861	18,256,110	183	5
Accretion of Series B and Series D redeemable convertible preferred stock redemption value	--	--	--	--	
Exercise of stock options	--	--	1,956,820	20	
Exercise of warrant	--	--	314,476	3	
Deferred compensation related to stock option grants	--	--	--	--	3
Amortization of deferred compensation	--	--	--	--	
Conversion of preferred stock into common stock	(2,756,789)	(2,861)	31,419,278	314	13
Common stock issued to the holders of Series C convertible preferred stock and Series D redeemable convertible preferred stock in lieu of special payments (Note 5)	--	--	242,500	2	1
Initial and follow-on public offerings of common stock	--	--	13,361,840	134	153
Net loss	--	--	--	--	
Balance, December 31, 1999	--	--	65,551,024	656	178
Exercise of stock options of $23,057 related to the income tax benefit of disqualifying dispositions	--	--	2,164,234	21	27
Issuance of common stock in connection with the employee stock purchase plan	--	--	179,099	2	1
Options issued in connection with the acquisition of Toronto Technology Group, Inc.	--	--	--	--	2
Amortization of deferred compensation	--	--	--	--	
Reversal of deferred compensation	--	--	--	--	
Net income	--	--	--	--	
Balance, December 31, 2000	--	$--	67,894,357	$679	$209

	ACCUMULATED DEFICIT	STOCKHOLDERS' EQUITY (DEFICIT)
Balance, December 31, 1997	$(6,890)	$(4,060)
Sale of Series C convertible preferred stock	--	400
Issuance costs related to sale of Series D redeemable convertible preferred stock	(106)	(106)

Accretion of Series B and Series D redeemable convertible preferred stock to redemption value	(434)	(434)
Exercise of stock options	--	73
Deferred compensation related to stock option grants	--	--
Amortization of deferred compensation	--	107
Warrants issued in connection with the sale of Series D redeemable convertible preferred stock	--	2,775
Issuance of Series B redeemable convertible preferred stock warrants	(1,053)	--
Grants of options to consultants (Note 6(b))	--	4
Issuance of warrants (Note 3(d))	--	58
Net loss	(2,851)	(2,851)
Balance, December 31, 1998	(11,334)	(4,034)
Accretion of Series B and Series D redeemable convertible preferred stock redemption value	(2,576)	(2,576)
Exercise of stock options	--	835
Exercise of warrant	--	--
Deferred compensation related to stock option grants	--	--
Amortization of deferred compensation	--	1,127
Conversion of preferred stock into common stock	--	10,889
Common stock issued to the holders of Series C convertible preferred stock and Series D redeemable convertible preferred stock in lieu of special payments (Note 5)	(1,819)	--
Initial and follow-on public offerings of common stock	--	153,276
Net loss	(13,132)	(13,132)
Balance, December 31, 1999	(28,861)	146,385
Exercise of stock options, of $23,057 related to the income tax benefit of disqualifying dispositions	--	27,726
Issuance of common stock in connection with the employee stock purchase plan	--	1,883
Options issued in connection with the acquisition of Toronto Technology Group, Inc.	--	219
Amortization of deferred compensation	--	1,273
Reversal of deferred compensation	--	--
Net income	14,487	14,487
Balance, December 31, 2000	$(14,374)	$191,973

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

Art Technology Group, Inc. Consolidated Statements of Cash Flows
(in thousands)

YEARS ENDED DECEMBER 31,

	1998	1999	2000
Cash Flows from Operating Activities:			
Net income (loss)	$(2,851)	$(13,132)	$14,487
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities--			
Stock-based compensation	111	1,127	1,273
Noncash interest expense related to issuance of warrants	18	40	--
Depreciation and amortization	347	836	3,629
Tax benefit from the exercise of stock options	--	--	23,057
Loss on disposal of fixed assets, net	--	120	27
Changes in operating assets and liabilities--			
Accounts receivable, net	(1,575)	(10,221)	(39,901)
Unbilled services	(93)	(491)	(491)
Prepaid expenses and other current assets	(112)	(1,795)	(2,314)
Deferred tax assets	--	--	(20,635)
Accounts payable	(128)	10,564	90
Accrued expenses	827	3,508	24,674
Deferred revenue	515	7,459	14,428
Net cash (used in) provided by operating activities	(2,941)	(1,985)	18,324
Cash Flows from Investing Activities:			
Purchases of marketable securities, net	--	(24,531)	(66,421)
Purchases of property and equipment	(623)	(5,579)	(21,683)
Acquisition of Petronio Technology Group, Inc.	--	--	(600)
Acquisition of The Toronto Technology Group, Inc.	--	--	(5,191)
(Increase) decrease in other assets	(44)	(690)	563
Net cash used in investing activities	(667)	(30,800)	(93,332)
Cash Flows from Financing Activities:			
Proceeds from exercise of stock options	73	835	4,669
Proceeds from employee stock purchase plan	--	--	1,883
Payments on long term obligations	--	--	(3,000)
Net proceeds from sale of Series C convertible preferred stock	400	--	--
Net proceeds from sales of Series D redeemable convertible preferred stock	7,394	--	--
Net proceeds from initial and follow-on public offerings of common stock	--	153,276	--
Proceeds from line of credit	1,496	--	--
Payment on line of credit	(1,800)	--	--
Payments on term loan to a bank	(167)	(319)	--

Proceeds from equipment line of credit	200	--	--
Payments on capital lease obligations	(82)	(189)	--
Payments on equipment line of credit	--	(200)	--
Net cash provided by financing activities	7,514	153,403	3,552
Net Increase (Decrease) in Cash and Cash Equivalents	3,906	120,618	(71,456)
Cash and Cash Equivalents, Beginning of Period	187	4,093	124,711
Cash and Cash Equivalents, End of Period	$4,093	$124,711	$53,255
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the period for interest	$143	$87	$--
Cash paid during the period for income taxes	$--	$--	$175
Supplemental Disclosure of Noncash Investing and Financing Activities:			
Accretion of dividends, discounts and special payments on Series B, Series C, and Series D convertible preferred stock	$434	$4,395	$--
Value ascribed to Series B and Series D redeemable convertible preferred stock warrants	$3,828	$--	$--
Equipment acquired under capital leases	$87	$--	$--
Original issue discount related to warrants issued to a bank	$58	$--	$--
Conversion of preferred stock into common stock	$--	$13,750	$--
Value ascribed to options issued in connection with the acquisition of The Toronto Technology Group Inc.	$--	$--	$2,238
Income tax effect of disqualifying dispositions	$--	$--	$23,057
In connection with the acquisition of The Toronto Technology Group Inc., the following non-cash transaction occurred:			
Fair value of tangible assets acquired	$--	$--	$699
Intangible assets acquired	--	--	5,124

Liabilities assumed......................	--	--	(632)
Cash paid for acquisition including acquisition costs............	$--	$--	$5,191

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

Art Technology Group, Inc. Notes to Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Art Technology Group, Inc. (ATG or the Company) is a Delaware company 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 consolidated financial statements reflect the application of certain significant accounting policies, as described below and elsewhere in the accompanying notes to the consolidated financial statements.

(a) Principles of Consolidation

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

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

(c) Public Offerings of Common Stock

On July 26, 1999, ATG closed its initial public offering of 10,000,000 shares of common stock at a public offering price of $6 per share. The net proceeds to ATG from the offering were approximately $54,302,000. On July 30, 1999, in connection with the exercise of the underwriters' over-allotment option, ATG issued an additional 336,000 shares of common stock at the initial public offering price of $6 per share. Net proceeds to ATG from the exercise of the over-allotment option were approximately $1,875,000. In connection with ATG's initial public offering in July 1999, all shares of preferred stock were converted into 31,419,278 shares of common stock.

On November 10, 1999, ATG closed its follow-on public offering of 9,000,000 shares of common stock, of which 2,850,000 shares were sold by the Company at a public offering price of $33.75. The net proceeds

to ATG from the offering were approximately $91,428,000. On November 22, 1999, in connection with the exercise of the underwriters' over-allotment option, ATG issued an additional 175,840 shares of common stock at the public offering price of $33.75 per share. Net proceeds to ATG from the exercise of the over-allotment option were approximately $5,671,000.

(d) Revenue Recognition

ATG recognizes product license revenue from licensing the rights to use its software to end-users. ATG also generates service revenues from integrating its software with its customers' operating environments, the sale of maintenance services and the sale of certain other consulting and development services. ATG generally has separate agreements with its customers, which

govern the terms and conditions of its software 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, which is generally ratably over the life of the reseller agreement, for guaranteed minimum royalties or based upon actual sales by the resellers. ATG does not grant its resellers the right of return or price protection. Revenues from professional service arrangements are recognized on either a time-and-materials or percentage-of-completion basis as the services are performed, provided that amounts due from customers are fixed or determinable and deemed collectible by management. Amounts collected or billed prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Unbilled services represent service revenues that have been earned by ATG in advance of billings.

(e) 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 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. The following table sets forth basic and diluted net income (loss) per share computational data for the years ended December 31, 1998, 1999 and 2000 (in thousands, except per share amounts):

	1998	1999	2000
Net income (loss) available for common stockholders	$(4,445)	$(17,527)	$14,487
Weighted average common shares outstanding used in computing basic net income (loss) per share	17,934	38,777	66,932
Weighted average common equivalent shares outstanding:			
Employee common stock options(1)(2)	--	--	6,206
Total weighted average common and common equivalent shares outstanding used in computing diluted net income (loss) per share	17,934	38,777	73,138
Basic net income (loss) per share	$(0.25)	$(0.45)	$0.22
Diluted net income (loss) per share	$(0.25)	$(0.45)	$0.20

(1) Options and warrants to purchase a total of 11,366,000 and 8,348,000 common shares have been excluded from the computation of diluted weighted average shares outstanding for the years ended December 31, 1998 and 1999, as the effect of their inclusion would have been anti-dilutive.

(2) Options to purchase a total of 3,902,173 weighted shares of common stock outstanding for the year ended December 31, 2000 were excluded from the calculation of diluted net income per share because the exercise prices of those options exceeded the average market price of common stock during the periods, as the effect of their inclusion would have been anti-dilutive.

(f) Cash, Cash Equivalents and Marketable Securities

ATG accounts for investments under SFAS No. 115, ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES. Under SFAS No. 115, investments for which ATG has the positive intent and the ability to hold to maturity, consisting of cash equivalents and marketable securities, are reported at amortized cost, which approximates fair market value. Cash equivalents are highly liquid investments with original maturities of less than 90 days. Marketable securities are investment grade securities with original maturities of greater than 90 days. At December 31, 1999 and 2000, all of ATG's marketable securities were held in commercial paper and corporate bonds and were classified as held-to-maturity. The average maturity of

ATG's marketable securities is approximately 13.6 months and 11.4 months at December 31, 1999 and 2000, respectively. At December 31, 1999 and 2000, the difference between the amortized cost and market value of ATG's marketable securities was approximately $24,000 and $181,000, respectively. At December 31, 1999 and 2000, ATG's cash, cash equivalents and marketable securities consisted of the following:

	DECEMBER 31, 1999	DECEMBER 31, 2000
	(IN THOUSANDS)	
Cash and cash equivalents--		
Cash	$ 884	$ 4,880
Money market accounts	123,827	35,314
Corporate securities	--	13,061
Total cash and cash equivalents	$124,711	$53,255
Marketable securities--		
Corporate securities	$24,531	$90,952
Total marketable securities	$24,531	$90,952

(g) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. ATG provides for depreciation and amortization using the straight-line method and it charges to operations the amounts estimated to allocate the cost of the assets over their estimated useful lives.

Property and equipment at December 31, 1999 and 2000 consisted of the following:

ASSET CLASSIFICATION	ESTIMATED USEFUL LIFE	DECEMBER 31, 1999	DECEMBER 31, 2000
		(IN THOUSANDS)	
Computer equipment	3 years	$3,577	$ 9,786
Leasehold improvements	Lesser of useful life or life of lease	1,721	11,990
Furniture and fixtures	7 years	1,321	4,496
Computer software	3 years	530	2,011
		7,149	28,283

Less--Accumulated depreciation and amortization	1,684	4,791
	$5,465	$23,492

Depreciation expense included in the accompanying statements of operations was approximately $347,000, $836,000 and $3,768,000 for the years ended December 31, 1998, 1999 and 2000, respectively.

(h) Research and Development Expenses for Software Products

ATG has evaluated the establishment of technological feasibility of its products in accordance with SFAS No. 86, ACCOUNTING FOR THE COSTS OF COMPUTER SOFTWARE TO BE SOLD, LEASED, OR

OTHERWISE MARKETED. ATG sells products in a market that is subject to rapid technological change, new product development and changing customer needs; accordingly, ATG has concluded that technological feasibility is not established until the development stage of the product is nearly complete. ATG defines technological feasibility as the completion of a working model. The time period during which costs could be capitalized, from the point of reaching technological feasibility until the time of general product release, is very short and, consequently, the amounts that could be capitalized are not material to ATG's financial position or results of operations. Therefore, ATG has charged all such costs to research and development in the period incurred.

(i) Income Taxes

ATG accounts for income taxes in accordance with the provisions of SFAS No. 109, ACCOUNTING FOR INCOME TAXES. This statement requires ATG to recognize a current tax asset or liability for current taxes payable or refundable and to record a deferred tax asset or liability for the estimated future tax effects of temporary differences and carryforwards to the extent that they are realizable. A deferred tax provision or benefit results from the net change in deferred tax assets and liabilities during the year. A deferred tax valuation allowance is required if it is more likely than not that all or a portion of the recorded deferred tax assets will not be realized (see Note 4).

(j) Stock-Based Compensation

SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, requires the measurement of the fair value of stock options or warrants to be included in the statement of operations or disclosed in the notes to financial statements. ATG has determined that it will continue to account for stock-based compensation for employees under the Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and elect the disclosure-only alternative under SFAS No. 123 (see Note 6(b)).

(k) Comprehensive Income (Loss)

ATG's comprehensive income (loss) is equal to its reported consolidated net income (loss) for all periods presented.

(l) Fair Value of Financial Instruments

Financial instruments consist mainly of cash and cash equivalents, marketable securities, accounts receivable, accounts payable and long-term obligations. The carrying amounts of these instruments approximate their fair value.

(m) Concentrations of Credit Risk

SFAS No. 105, DISCLOSURE OF INFORMATION ABOUT FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK AND FINANCIAL INSTRUMENTS WITH CONCENTRATIONS OF CREDIT RISK, requires disclosure of any significant off-balance-sheet and credit risk concentrations. ATG has no significant off-balance-sheet concentrations such as foreign exchange contracts, option contracts or other foreign hedging arrangements. To reduce its credit risk, the Company routinely assesses the financial strength of its customers. ATG maintains an allowance for potential credit losses but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area. ATG places its cash, cash equivalents and marketable securities in several accredited financial institutions. ATG has not experienced any material losses to date.

For the years ended December 31, 1999 and 2000, no customers accounted for more than 10% of the Company's total revenues. For the year ended December 31, 1998, three customers each accounted for 17%, 10% and 10% of the Company's total revenues.

As of December 31, 2000, no customers accounted for greater than 10% of accounts receivable. As of December 31, 1999, one customer accounted for 12% of accounts receivable.

(n) Long-Lived Assets

The Company assesses the realizeability of intangible assets in accordance with SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF. Under SFAS No. 121, the Company is required to assess the valuation of its long-lived assets, including intangible assets, based on the estimated cash flows to be generated by such assets. The Company believes that no material impairment of long-lived assets exist at December 31, 2000.

(o) Foreign Currency Translation

The financial statements of the Company's foreign subsidiaries are translated in accordance with SFAS No. 52, FOREIGN CURRENCY TRANSLATION. The functional currency of the Company's foreign subsidiaries is the U.S. dollar. Accordingly, all assets and liabilities of the foreign subsidiaries are translated using the exchange rate at the balance sheet date, except for property and equipment, other assets and stockholders' equity, which are translated at historical rates. Revenues and expenses are translated at historical rates. Translation gains and losses arising from the translations, were not material to the financial statements taken as a whole for the year ended December 31, 2000.

(p) Recent Accounting Pronouncements

In September 2000, the Financial Accounting Standards Board (FASB) issued SFAS No. 140, ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENT OF LIABILITIES, which supercedes SFAS No. 125. SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001 and for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. The Company does not expect the adoption of SFAS No. 140 to have a material impact on the results of its consolidated financial position or results of operations.

In June 1998, the FASB issued SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. As amended in June 1999 by SFAS No. 137, the statement is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. In June 2000, the FASB issued SFAS No. 138, ACCOUNTING FOR CERTAIN DERIVATIVE INSTRUMENTS AND CERTAIN HEDGING ACTIVITIES which is a significant amendment to SFAS No. 133. SFAS No. 133 and its amendments establish accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. The Company does not expect the adoption of these statements to have a material impact on its consolidated financial position or results of operations.

(2) DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE

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

Revenues from sources outside of the United States were approximately $850,000, $2,245,000, and $37,569,000 in 1998, 1999 and 2000, respectively. ATG's revenues from international sources were primarily generated from customers located in Europe and Asia/Pacific. All of the ATG's product sales for the years ended December 31, 1998, 1999 and 2000 were delivered from its headquarters located in the United States.

The following table represents the percentage of total revenues by geographic region from customers for 1998,1999 and 2000:

	YEARS ENDED DECEMBER 31,		
	1998	1999	2000
United States	93%	93%	77%
Europe, Middle East and Africa	4	6	19
Asia Pacific	--	1	2
Other	3	--	2
	100%	100%	100%

(3) LONG-TERM OBLIGATIONS

(a) Credit Facility

ATG has a working capital line-of-credit agreement with a bank, which provides for borrowings of up to the lesser of $12,500,000 or 80% of eligible accounts receivable. The line of credit bears interest at the bank's prime rate (9.5% at December 31, 2000) and expires in 2001. As of December 31, 2000 approximately $5,077,000 was available for future borrowings. The working capital line of credit is secured by all of ATG's tangible and intangible intellectual and personal property and is subject to financial covenants and restrictions, including minimum liquidity requirements and a prohibition on the payment of dividends. As of December 31, 2000, ATG was in compliance with all covenants.

As of December 31, 2000, there were no amounts outstanding under the working capital line of credit; however, ATG had commitments totaling approximately $7,423,000 in the form of outstanding standby letters of credit in favor of ATG's various landlords to secure obligations under ATG's facility leases.

(b) Non-Recourse Receivables Purchase Agreement with a Bank

In September 2000, ATG entered into a Non-Recourse Receivables Purchase Agreement with a bank (the Receivables Agreement), whereby ATG can sell up to $10.0 million of its accounts receivable to the bank. Under the terms of the Receivables Agreement, ATG can sell certain accounts receivable, subject to acceptance by the bank, on a non-recourse basis. Upon purchase, the bank assumes the risk of collection for the acquired accounts receivable except in the event that ATG violates the terms of the receivables purchase agreement or the customer asserts a discount, allowance, warranty claim or right of return. The accounts receivable are sold at a discount to reflect a minimum of 45 days and a maximum of 135 days at the bank's prime rate (9.5% at December 31, 2000) plus 1%. This agreement will expire in September 2001. In September 2000, ATG sold $9.6 million of accounts receivable to the bank under the Receivables Agreement. ATG has determined that, in accordance with SFAS No. 125 ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES and SFAS No. 140, the transaction is accounted for as a sale of accounts receivable and accordingly has reduced accounts receivable by the amount of the accounts receivable which have

been sold in the accompanying consolidated balance sheets. As of December 31, 2000, $3,906,000 of the sold receivables were uncollected. For the year ended December 31, 2000, ATG incurred approximately $166,000 in expenses related to this transaction.

(c) Equipment Line of Credit

On July 2, 1998, ATG entered into an equipment line of credit with a bank. Under the equipment line of credit, ATG could borrow up to $200,000 for capital expenditures. During 1998, ATG borrowed $199,915, all of which was outstanding as of December 31, 1998. Borrowings bore interest at the bank's prime rate plus 1.25%. In July 1999, in connection with ATG's initial public offering, ATG repaid all outstanding amounts under the line of credit.

In April 1999, ATG entered into an additional equipment line of credit with the same bank. Under the equipment line of credit, ATG may borrow up to $200,000 for capital expenditure purchases. Borrowings bear interest at the bank's prime rate (9.5% at December 31, 2000) plus 0.75%. Interest accrues and is payable monthly. Principal is due in 30 monthly installments following a six-month interest-only period. The equipment line of credit expired during the year ended December 31, 2000.

(d) Term Note Payable to a Bank

ATG entered into a term note payable with a bank under which ATG could have borrowed up to $500,000 based upon certain conditions, as defined. Borrowings bore interest at the bank's prime rate plus 1%. During July 1999, in connection with ATG's initial public offering, all amounts were repaid. In connection with

the term note payable, ATG issued warrants to purchase 56,296 shares of Series C convertible preferred stock to the bank. One warrant provided for the purchase of 46,296 shares at an exercise price of $1.62 per share and the other warrant provided for the purchase of 10,000 shares at an exercise price of $0.01 per share. These warrants vested immediately. ATG valued the warrants at $58,000, using the Black-Scholes option pricing model and the following assumptions: fair market value of the stock of $1.62; risk free interest rate of 4.74%; an expected volatility factor of 70%; an expected life of four years; and an expected dividend yield of zero. The warrants were recorded as a debt discount. For the years ended December 31, 1998 and 1999, ATG amortized $18,000 and $40,000, respectively. In July 1999, in connection with ATG's accelerated debt repayment, ATG amortized the remainder of the debt discount. In connection with ATG's initial public offering, the warrants were converted into warrants to purchase 342,970 shares of common stock. In July 1999, the warrants to purchase 342,970 shares of common stock were exercised through a cashless exercise resulting in the net issuance of 314,476 shares of common stock.

(e) BroadVision Settlement

In connection with a settlement of the patent infringement claim by BroadVision, ATG acquired a perpetual, paid-up license for BroadVision's patented technology. ATG paid $11,000,000 during the year ended December 31, 2000 and will pay the remaining $4,000,000 over the next two years in quarterly installments of $500,000. At December 31, 1999, these payments are included in the accompanying consolidated balance sheet as follows:

$8,000,000 in accounts payable, $3,000,000 in current maturities of long-term obligations and $4,000,000 in long-term obligations. At December 31, 2000, these payments are included in the accompanying consolidated balance sheet as follows: $2,000,000 in current maturities of long-term obligations and $2,000,000 in long-term obligations. ATG expensed $8,000,000 and $2,333,000 of the settlement as cost of service revenues in the years ended December 31, 1999 and 2000, respectively, and is amortizing the remainder over its remaining estimated life of two years.

(4) INCOME TAXES

Income (loss) before provision for income taxes consists of the following (in thousands):

	Years Ended December 31,		
	1998	1999	2000
Domestic	$(2,851)	$(13,132)	$16,651
Foreign	-	-	1,214
Total	$(2,851)	$(13,132)	$17,865

The provision for income taxes shown in the accompanying consolidated statements of operations is composed of the following (in thousands):

	Years Ended December 31,		
	1998	1999	2000
Federal			
Current	$ -	$ -	$8,780
Deferred	-	-	(7,385)
State			
Current	-	-	1,789
Deferred	-	-	(1,533)
Foreign			
Current	-	-	1,727
	$ -	$ -	$3,378

The provision for income taxes differs from the federal statutory rate due to the following:

	Years Ended December 31,		
	1998	1999	2000
Federal tax at statutory rate	34.0%	34.0%	35.0%
State taxes net of federal benefit	6.0	6.0	6.5
Meals and entertainment	-	-	6.1
Deferred compensation	-	-	4.9
Other	-	-	1.8
Valuation allowance	(40.0)	(40.0)	(35.4)
	- %	- %	18.9%

The components of the net deferred tax asset recognized in the accompanying consolidated balance sheets are as follows (in thousands):

	December 31, 1999	December 31, 2000
Deferred tax assets	$ -	$20,846
Deferred tax liabilities	-	(211)
	$ -	$20,635

The approximate tax effect of each type of temporary difference and carryforward is as follows (in thousands):

	December 31, 1999	December 31, 2000
Cummulative temporary differences	$ 4,154	$ 6,882
US Income tax credits	642	642
Net operating losses	3,555	14,110
Acquisition related	-	(999)
Valuation allowance	(8,351)	-
	$ -	$20,635

As of December 31, 2000, ATG had net operating loss carryforwards of approximately $42.2 million for federal income tax purposes and approximately $49.6 million for state income tax purposes. Approximately $31.8 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 and state income tax purposes. ATG also has available federal tax credit carryforwards of approximately $642,000. If not utilized, these carryforwards will expire at various dates beginning 2011 and ending 2020. If substantial changes in ATG's ownership should occur, as defined by Section 382 of the Internal Revenue Code (the Code), there could be annual limitations on the amount of carryforwards that can be realized in future periods. ATG has completed several refinancings since its inception and has incurred ownership changes, as defined under the Code. ATG does not believe that those changes in ownership will have a material impact on its ability to use its net operating loss and tax credit carryforwards.

(5) PREFERRED STOCK

As of December 31, 1998, ATG's Board of Directors had authorized 10,000,000 shares of preferred stock and had designated 1,300,000, 851,064, 2,000,000 and 2,343,750 shares as Series A convertible preferred stock (Series A Preferred Stock), Series B redeemable convertible preferred stock (Series B Preferred Stock), Series C convertible preferred stock (Series C Preferred Stock) and Series D redeemable convertible preferred stock (Series D Preferred Stock), respectively. On July 26, 1999, in conjunction with ATG's initial public offering, all outstanding shares of preferred stock were converted into shares of common stock. Additionally, all authorized shares were cancelled.

In conjunction with the issuance of the Series B Preferred Stock in December 1996, ATG issued to a holder of Series B Preferred Stock a performance-based warrant to purchase up to 425,532 shares of Series B Preferred Stock at $7.05 per share. The performance criteria was based upon sales generated by ATG from the affiliates of the Series B Stockholder. ATG generated negligible revenues from the affiliates of the Series B Stockholder; therefore, the warrant was not measured or recorded. As a condition for obtaining the Series B Stockholder's approval of the terms of the Series D Preferred Stock

financing in 1999, the warrant was canceled and ATG granted to the Series B Preferred Stockholder a new warrant to purchase 425,532 shares of ATG's Series B Preferred Stock at a purchase price of $1.385 per share, which was immediately exercisable and fully vested. The warrant was to expire on the earlier of: (1) the closing of a public offering of ATG's common stock, as defined, at a price of at least $10 per share resulting in gross proceeds to ATG of at least $10,000,000, (2) the closing of a liquidation, merger, sale of all or substantially all assets of ATG or other similar event, as defined, or (3) August 18, 2003. ATG has valued this warrant at $1,053,000, using the Black-Scholes option pricing model and the following assumptions: a fair market value of $3.20 per share, a risk-free interest rate of 5.0%, an expected volatility of 70%, an expected life of five years, and an expected dividend yield of zero. ATG has recorded the value of the warrant in the accompanying statement of stockholders' equity (deficit) and as a component of dividends on preferred stock in computing net loss per share available to common stockholders for the year ended December 31, 1999.

In addition, in connection with the issuance of the Series D Preferred Stock, ATG issued to the holders of Series D Preferred Stock, warrants to purchase up to 4,292,650 shares of ATG's common stock at $0.11 per share, adjusted for certain dilutive events, as defined. The warrants were to vest 5% per quarter beginning on September 30, 1998 and expire August 18, 2003. ATG valued these warrants using the Black-Scholes option pricing model and the following assumptions: a fair market value of $3.20 per share, a risk free interest rate of 4.74%, an expected volatility of 70%, an expected life of five years and an expected dividend yield of zero. ATG allocated the consideration received from the sale of the Series D preferred stock of $7,500,000 between the Series D preferred stock and

warrants on the basis of the fair value of the individual component at the date of issuance and determined that the warrants were valued at $2,775,000. These warrants were recorded as a discount to the Series D Preferred Stock and the resulting discount was amortized over the redemption period in computing net loss per share. For the years ended December 31, 1999 and 1998, ATG amortized $2,491,000 and $284,000, respectively. The amortization for the year ended December 31, 1999 included the accelerated amortization in connection with the conversion of the Series D Preferred Stock in connection with the initial public offering.

In conjunction with ATG's initial public offering, the warrants to purchase Series B Preferred Stock and common stock were canceled and the number of shares of common stock issuable upon conversion of the Series B and D Preferred Stock were increased to reflect the shares that would have been received upon exercise of the warrants based upon the initial public offering price.

(6) STOCKHOLDERS' EQUITY

(a) Stock Splits and Authorized Shares of Common Stock

ATG's authorized capital stock at December 31, 2000 consists of 10,000,000 shares of $0.01 par value preferred stock and 500,000,000 shares of $0.01 par value common stock.

On February 28, 2000, ATG's Board of Directors approved a 2-for-1 stock split of ATG's common stock. The split was effective on March 10, 2000. In addition, on May 10, 1999, ATG's Board of Directors approved a 3-for-2

stock split of ATG's common stock. The stock split was effective on June 18, 1999. All share and per share amounts of common stock for all periods have been retroactively adjusted to reflect the stock splits.

(b) Stock Plans

1996 STOCK OPTION PLAN

In April 1996, the 1996 Stock Option Plan (the 1996 Plan) was approved by ATG's Board of Directors and stockholders. The purpose of the 1996 Plan is to reward employees, officers and directors, and consultants and advisors to ATG who are expected to contribute to the growth and success of ATG. The 1996 Plan provides for the award of options to purchase shares of ATG's common stock.

Stock options granted under the 1996 Plan may be either incentive stock options or nonqualified stock options.

The 1996 Plan is administered by the Board of Directors, which has the authority to designate participants, determine the number and type of options to be granted, the time at which options are exercisable, the method of payment and any other terms or conditions of the options. Options generally vest annually over a two- to four-year period and expire 10 years from the date of grant.

While the Board determines the prices at which options may be exercised under the 1996 Plan, the exercise price of an incentive stock option shall be at least 100% (110% for incentive stock options granted to a 10% stockholder) of the fair market value of ATG's common stock on the date of grant. A total of 19,600,000 shares of common stock have been reserved for options to be granted under the 1996 Plan. As of December 31, 2000, there are 4,469,000 shares available for future grant under the 1996 Plan.

Additionally, in May 1999, ATG granted 150,000 options outside ATG's stock option plans to an executive of ATG. At December 31, 2000 these options have not been exercised.

1999 OUTSIDE DIRECTOR STOCK OPTION PLAN

The 1999 Outside Director Stock Option Plan (Director Plan) was adopted by ATG's Board of Directors and approved by stockholders in May 1999. Under the terms of the Director Plan, nonemployee directors of ATG receive nonqualified options to purchase shares of common stock. A total of 300,000 shares of common stock have been reserved under the Director Plan.

Under the terms of the Director Plan, each currently active nonemployee director received an option to purchase 10,000 shares of common stock on the effective date of the Company's initial public offering at the public offering price. Individuals who become directors after the initial public offering and are not employees of ATG will receive an option to purchase 10,000 shares of our common stock on the date of initial election to ATG's Board of Directors at an exercise price equal to the then current fair market value. In addition, each non-employee director will receive an option to purchase 5,000 shares of common stock on the date of each annual meeting of stockholders commencing in the year 2000 at an exercise price per share equal to the closing price of ATG's common stock on the date of grant. All options granted under the Director Plan will be fully vested

upon grant. As of December 31, 2000, there are 215,000 shares available for future grant under the Director Plan.

1999 EMPLOYEE STOCK PURCHASE PLAN

The 1999 Employee Stock Purchase Plan (the Stock Purchase Plan) was adopted by ATG's Board of Directors and approved by stockholders in May 1999. The Stock Purchase Plan authorizes the issuance of up to a total of 1,000,000 shares of ATG's common stock to participating employees. All ATG's employees, including directors who are employees, are eligible to participate in the Stock Purchase Plan. Employees who would immediately after the grant own 5% or more of the total combined voting power or value of our stock are not eligible to participate. During each designated semiannual offering period, each eligible employee may deduct between 1% to 10% of base pay to purchase common stock of ATG. The purchase price will be 85% of the closing market price of ATG's common stock on either: (1) the first business day of the offering period or (2) the last business day of the offering period, whichever is lower.

ATG accounts for the Stock Purchase Plan in accordance with APB No. 25 and, accordingly, no compensation cost has been recognized under the Stock Purchase Plan. ATG has elected the "disclosure only" alternative under SFAS No. 123.

The following table summarizes ATG's option activity:

	NUMBER OF SHARES	EXERCISE PRICE	WEIGHTED AVERAGE EXERCISE PRICE
	(IN THOUSANDS, EXCEPT PER SHARE INFORMATION)		
Outstanding, December 31, 1997	4,280	$ .07-.25	$.18
Granted	3,272	.25	.25
Exercised	(442)	.07-.25	.17
Canceled	(1,232)	.07-.25	.22
Outstanding, December 31, 1998	5,878	.07-.25	.22
Granted	4,960	1.00-52.50	14.52
Exercised	(1,957)	.07-5.75	.40
Canceled	(543)	.07-5.75	1.20
Outstanding, December 31, 1999	8,338	.07-52.50	8.65
Granted	4,917	.06-120.00	66.93
Exercised	(2,164)	.07-81.56	2.23
Canceled	(549)	.06-120.00	22.25
Outstanding, December 31, 2000	10,542	$.06-120.00	$36.42
Exercisable, December 31, 2000	2,297	$.06-120.00	$13.81
Exercisable, December 31, 1999	2,200	$ .07-19.03	$ 1.16
Exercisable, December 31, 1998	2,488	$ .07-.25	$ .19

The following table summarizes information relating to currently outstanding and exercisable options as of December 31, 2000:

	OUTSTANDING			EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OF SHARES	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE OUTSTANDING (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
(IN THOUSANDS EXCEPT PER SHARE INFORMATION)				(IN THOUSANDS EXCEPT PER SHARE INFORMATION	
$.06-$.08	150	6.0	$ .08	140	$ .08
.25	1,655	7.3	.25	758	.25
1.00-1.33	606	8.1	1.14	232	1.14
1.67-2.00	119	8.2	1.79	33	1.85
4.00-6.00	1,996	8.4	4.85	578	4.94
11.61-13.41	214	8.7	13.38	62	13.40
19.03-28.13	147	8.8	19.19	34	19.03
28.56-40.88	868	9.9	33.88	12	32.37
44.00-65.69	2,211	9.2	52.07	311	52.03
67.88-95.00	2,127	9.5	79.83	135	74.84
101.94-120.00	449	9.6	118.00	2	101.94
	10,542	8.8	$ 36.42	2,297	$ 13.81

In the year ended December 31, 1998, ATG granted 30,000 nonqualified stock options exercisable at $0.25 per share, which are fully vested, to consultants as payment for services performed. ATG recorded an expense for the year ended December 31, 1998 related to this grant of $4,000. ATG valued the options issued in exchange for services based upon the Black-Scholes option pricing model and the following assumptions: a fair market value of $0.81; risk free interest at 4.74%; an expected volatility factor of 70%; an expected life of four years; and an expected dividend yield of zero. The options expire 10 years from the date of grant.

Since the fourth quarter of 1998, ATG has recorded deferred compensation of approximately $4.9 million, which represents the aggregate difference between the exercise price and the fair market value of the common stock, as determined for accounting purposes. The deferred compensation is being recognized as an expense

over the vesting period of the underlying stock options. ATG recorded compensation expense of $107,000, $1,127,000, and $1,013,000 for the years ended December 31, 1998, 1999, and 2000, respectively, related to these options.

ATG has computed the pro forma disclosures required under SFAS No. 123 for options granted during the years ended December 31, 1998, 1999 and 2000. The fair value of options granted during the years ended December 31, 1998, 1999 and 2000 was approximately $462,000 or $0.07 per share, $53,234,000 or $10.84 per share and $256,901,000 or $52.64 per share, respectively. These amounts will be amortized over the underlying option period. The amounts were computed using the Black-Scholes option pricing model prescribed by SFAS No. 123. The assumptions used and weighted average calculations are as follows:

	YEARS ENDED DECEMBER 31,		
	1998	1999	2000
Risk-free interest rate	5.00%	5.29-6.06%	5.92%
Expected dividend yield	--	--	--
Expected lives	4 years	4 years	4 years
Expected volatility	70%	95%	115%
Weighted average remaining contractual life of options outstanding	8.40 years	8.90 years	8.80 years

Had compensation expense for ATG's stock option plans been determined consistent with SFAS No. 123, the pro forma net loss available for common stockholders and pro forma net loss per share would have been as follows:

	YEARS ENDED DECEMBER 31,		
	1998	1999	2000
	(IN THOUSANDS, EXCEPT SHARE INFORMATION)		
Net income (loss) available for common stockholders--			
As reported	$(4,445)	$(17,527)	$ 14,487
Pro forma	$(4,755)	$(20,225)	$(13,786)
Basic net income (loss) per share--			
As reported	$ (0.25)	$ (0.45)	$ 0.22
Pro forma	$ (0.27)	$ (0.52)	$ (0.21)
Diluted net income (loss) per share--			
As reported	$ (0.25)	$ (0.45)	$ 0.20
Pro forma	$ (0.27)	$ (0.52)	$ (0.21)

(7) ACQUISITIONS

On June 1, 2000, ATG completed the acquisition of Petronio Technology Group, a Boston-based provider of educational training and consulting services. ATG acquired Petronio Technology Group for $1,200,000, consisting of an initial payment of $600,000 at the closing and two annual contingent payments of $300,000 each. The acquisition has been accounted for under the purchase method of accounting and the results of operations for Petronio Technology Group have been included in ATG's results from the acquisition date. ATG recorded $600,000 in goodwill that is being amortized over two years and the Company is recognizing the contingent payments as compensation expense ratably over the two-year vesting period. For the year ended December 31, 2000, ATG recorded amortization expense of $188,000 and compensation expense of $188,000.

On July 17, 2000, ATG completed the acquisition of The Toronto Technology Group, Inc., a privately held 30-person consulting and educational services company based in Toronto, Canada, for approximately $12.0 million in cash, options and shares of common stock. The acquisition has been accounted for under the purchase method of accounting. Upon the closing of the transaction, ATG paid $5.2 million in cash, issued 19,634 employee stock options and also issued 56,237 exchangeable shares of ATG's subsidiary Art Technology Group (Canada), Inc. The exchangeable shares will become exchangeable for 56,237 shares of ATG's common stock, subject to a three-year vesting schedule. As of December 31, 2000, no shares are exchangeable. ATG allocated $2.75 million of the purchase price to the acquired workforce which is being amortized over five years. The remainder of the purchase price has been allocated to goodwill and is being amortized ratably over five years. Additionally, ATG is recording the value of the stock options and exchangeable shares of $7.5 million as compensation expense over three years. For the year ended December 31, 2000, ATG recorded compensation expense relating to the stock options and exchangeable shares of approximately $1,228,000. Additionally, amortization expense of approximately $482,000 was recorded based on the intangible assets.

(8) COMMITMENTS AND CONTINGENCIES

(a) Leases

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 has issued the lessor a letter of credit in the amount of $1,500,000 as a security deposit. Additionally, ATG has offices, primarily for sales and support personnel, in ten 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 December 31, 2000 are as follows:

YEARS ENDING DECEMBER 31,	OPERATING LEASES
	(in thousands)
2001	$9,084
2002	10,327
2003	10,259
2004	8,958
2005	9,660
Thereafter	33,266

Total future minimum lease payments..................	$81,554

Rent expense included in the accompanying statements of operations was approximately $810,000, $1,752,000, and $6,029,000 for the years ended December 31, 1998, 1999, and 2000 respectively.

(9) EMPLOYEE BENEFIT PLAN

Effective January 1, 1997, ATG adopted the Art Technology Group 401(k) Plan (the 401(k) Plan). All employees, as defined, are eligible to participate in the 401(k) Plan. The 401(k) Plan allows eligible employees to make salary-deferred contributions of up to 15% of their annual compensation, as defined, subject to certain Internal Revenue Service limitations. ATG may contribute to the 401(k) Plan at its discretion. No discretionary employer contributions were made to the Plan for the years ended December 31, 1998 or 1999. For the year ended December 31, 2000, ATG made a discretionary contribution to the Plan of approximately $888,000.

(10) ACCRUED EXPENSES

Accrued expenses at December 31, 1999 and 2000 consist of the following:

	DECEMBER 31,	
	1999	2000
	(IN THOUSANDS)	
Payroll and related costs.........................	$3,066	$18,006
Accrued accounts payable..........................	817	1,376
Other...	845	10,020
	$4,728	$29,402

(11) VALUATION AND QUALIFYING ACCOUNTS

The following is a rollforward of ATG's allowance for doubtful accounts (in thousands):

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS	DEDUCTIONS	BALANCE A OF PERI

Year Ended December 31, 1998........	$ 21	$ 265	$ (36)	$ 250
Year Ended December 31, 1999........	$250	$ 210	$ --	$ 460
Year Ended December 31, 2000........	$460	$2,976	$(781)	$2,655

(12) QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table presents a condensed summary of quarterly results of operations for the years ended December 31, 1999 and 2000:

	Year Ended December 31, 1999			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenues............	$4,420	$6,233	$8,140	$13,284
Gross profit..............	2,607	3,985	5,532	1,561
Net loss..................	(877)	(1,396)	(1,382)	(9,477)
Net loss per share				
Basic........	(0.06)	(0.08)	(0.10)	(0.15)
Diluted........	(0.06)	(0.08)	(0.10)	(0.15)

	Year Ended December 31, 2000			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenues............	$21,572	32,629	46,310	62,831
Gross profit..............	15,872	24,867	35,318	49,120
Net income (loss).........	(607)	2,869	5,009	7,216
Net income (loss) per share				
Basic.............	(0.01)	0.04	0.07	0.11
Diluted.............	(0.01)	0.04	0.07	0.10

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Item 11. EXECUTIVE COMPENSATION

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

All information required by Items 10, 11, 12 and 13 is incorporated herein by reference to our definitive proxy statement for its annual meeting of stockholders to be held on May 14, 2001, to be filed with the SEC pursuant to Regulation 14A.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) Financial Statements

The following consolidated financial statements are included in Item 8:
- Report of Independent Public Accountants
- Consolidated Balance Sheets as of December 31, 1999 and 2000
- Consolidated Statements of Operations for the years ended December 31, 1998, 1999 and 2000
- Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 1998, 1999 and 2000
- Consolidated Statements of Cash Flows for the years ended December 31, 1998, 1999 and 2000
- Notes to Consolidated Financial Statements

(a) (2) Financial Statement Schedule

None

(a) (3) EXHIBITS

The following exhibit are included in Item 14(c):

Exhibit Number	Description
3.1*	Certificate of Incorporation of the Registrant, as currently in effect.
3.2*	Certificate of Amendment to Certificate of Incorporation of the Registrant.
3.4*	Amended and Restated By-Laws of the Registrant.
10.1*	1996 Stock Option Plan of the Registrant, as amended.
10.2*	1999 Outside Director Stock Option Plan of the Registrant.
10.3*	1999 Employee Stock Purchase Plan of the Registrant.
10.4*	Lease between the Registrant and DVPT Limited Partnership, dated March 11, 1999.
10.5*	Loan and Security Agreement between the Registrant and Silicon Valley Bank, dated November 26, 1997, as amended on March 31, 1998 and July 2, 1998.
10.6*	Intellectual Property Security Agreement between the Registrant and Silicon Valley Bank, dated November 26, 1997.
10.7*	Registration Rights Agreement betweent the Registrant and certain of its stockholders, dated August 18, 1998.

10.8*	Non-Compete Rights Agreement between the Registrant and Jeet Singh, dated August 18, 1998.
10.9*	Non-Compete Agreement between the Registrant and Joseph Chung, dated August 18, 1998.
10.10*	Fourth Loan Modification Agreement between the Registrant and Silicon Valley Bank, dated May 12, 1999
10.11	Registration Rights Agreement between the Registrant and certain of its stockholders, dated July 17, 2000.
10.12	Loan and Security Agreement between the Registrant and Silicon Valley Bank, dated December 29, 2000.
10.13	Non-Recourse Receivables Purchase Agreement dated September 27, 2000.
21	Schedule of Registrant's Subsidiaries
23	Consent of Independent Public Accountants

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* Incorporated herein by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-78333).

Confidential materials omitted and filed separately with the Commission.

(b) REPORTS ON FORM 8-K

The Registrant filed a report on Form 8-K dated March 7, 2000 announcing a two-for-one stock split of its outstanding shares of common stock.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 March 27, 2001.

ART TECHNOLOGY GROUP, INC.
(Registrant)

By: /s/ Jeet Singh

Jeet Singh
Chief Executive Officer (Principal Executive Officer)

By: /s/ Ann C. Brady

Ann C. Brady
Vice President, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities as of March 27, 2001.

NAME	TITLE

/s/ Phyllis S. Swersky Phyllis S. Swersky	Director
/s/ Scott A. Jones Scott A. Jones	Director
/s/ Charles R. Lax Charles R. Lax	Director
/s/ Thomas N. Matlack Thomas N. Matlack	Director
/s/ Robert F. Walters Robert F. Walters	Director
/s/ Joseph T. Chung Joseph T. Chung	Chairman of the Board
/s/ Jeet Singh Jeet Singh	Director and Chief Executive Officer