ART TECHNOLOGY GROUP INC
Form 10-Q
May 12, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2003

OR

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

For the Transition Period from to

Commission file number 000-26679

ART TECHNOLOGY GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3141918**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

25 First Street, Cambridge, Massachusetts
(Address of principal executive offices)

02141
(Zip Code)

(617) 386-1000
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2 of the Exchange Act). Yes o No x

As of May 7, 2003 there were 71,431,020 shares of the Registrant s common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2003	December 31, 2002
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 49,022	$ 45,829
Marketable securities	17,617	22,729
Accounts receivable, net of reserves of $1,289 ($1,941 in 2002)	17,857	25,221
Unbilled services	20	5
Prepaid expenses and other current assets	2,641	2,484
Total Current Assets	87,157	96,268
Property and Equipment, Net	5,491	6,998
Other Assets	1,409	1,569
	$ 94,057	$ 104,835
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 2,166	$ 2,563
Accrued expenses	14,654	18,219
Deferred revenue	16,172	15,674
Accrued restructuring, short-term	16,698	19,819
Total Current Liabilities	49,690	56,275
Accrued restructuring, less current portion	31,001	32,537
Commitments and Contingencies Stockholders Equity:		
Preferred stock, $.01 par value		
Authorized 10,000,000		
Issued and outstanding no shares		
Common stock, $.01 par value		
Authorized 500,000,000		
Issued and outstanding 71,417,842 shares and 70,941,478 shares at March 31, 2003 and December 31, 2002 respectively	714	709
Additional paid-in capital	217,399	217,288
Deferred compensation	(133)	(394)
Accumulated deficit	(202,623)	(199,869)
Accumulated other comprehensive income	(1,991)	(1,711)
Total Stockholders Equity	13,366	16,023

	$ 94,057	$ 104,835

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

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

	Three Months Ended March 31,	
	2003	**2002**
Revenues:		
Product licenses	$ 7,505	$ 12,520
Services	11,920	14,803
Total Revenues	19,425	27,323
Cost of Revenues:		
Product licenses	485	1,043
Services	5,706	8,975
Total Cost of Revenues	6,191	10,018
Gross Profit	13,234	17,305
Operating Expenses:		
Research and development	4,860	5,570
Sales and marketing	8,768	12,378
General and administrative	2,640	2,490
Stock-based compensation	81	271
Total Operating Expenses	16,349	20,709
Loss from Operations	(3,115)	(3,404)
Interest and Other Income, Net	361	555
Net loss before provision for income taxes	(2,754)	(2,849)
Provision for Income Taxes		
Net loss	(2,754)	$ (2,849)
Basic and diluted net loss per share	(0.04)	$ (0.04)
Basic and diluted weighted average common shares outstanding	70,982	69,494

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

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

	Three Months Ended March 31,	
	2003	**2002**
Cash Flows from Operating Activities:		
Net loss	$ (2,754)	$ (2,849)
Adjustments to reconcile net loss to net cash used in operating activities		
Stock-based compensation	81	271
Depreciation and amortization	1,320	1,821
Loss on disposal of fixed assets, net	185	17
Changes in current assets and liabilities		
Accounts receivable, net	7,364	10,281
Unbilled services	(15)	87
Prepaid expenses and other current assets	(157)	1,106
Accounts payable	(397)	(1,144)
Accrued expenses	(3,565)	(5,461)
Deferred revenues	498	(1,477)
Accrued restructuring	(4,657)	(4,086)
Net cash used in operating activities	(2,097)	(1,434)
Cash Flows from Investing Activities:		
Net proceeds from sales of (purchases of) marketable securities	5,112	(13,548)
Purchases of property and equipment	(46)	(394)
Proceeds on sale of fixed assets	41	75
Decrease in other assets	160	900
Net cash provided by investing activities	5,267	(12,967)
Cash Flows from Financing Activities:		
Proceeds from exercise of stock options		42
Proceeds from employee stock purchase plan	296	1,034
Payments on long-term obligations		(500)
Net cash provided by financing activities	296	576
Effect of Foreign Exchange Rate Changes on Cash and Cash Equivalents	(273)	10
Net Decrease in Cash and Cash Equivalents	3,193	(13,815)
Cash and Cash Equivalents, Beginning of Period	45,829	49,493
Cash and Cash Equivalents, End of Period	$49,022	$ 35,678

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

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

(1) OPERATIONS AND BASIS OF PRESENTATION

Art Technology Group, Inc. (ATG or the Company) is a Delaware company incorporated on December 31, 1991. ATG offers an integrated suite of Internet online marketing, sales and service applications, as well as related application development, integration and support services.

ATG develops and markets software that enables consumer, retail and financial services companies to dynamically market, sell and provide services to their customers online. The Company offers proven, flexible online marketing, sales, and self-service software applications for consumer facing e-commerce sites. ATG also offers their clients related professional services including support, education and implementation services.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q. The disclosures do not include all of the information and footnotes required by accounting principles generally accepted in the United States and while the Company believes that the disclosures presented are adequate to make information not misleading, these financial statements should be read in conjunction with the audited financial statements and related notes included in the Company s 2002 Annual Report on Form 10-K. In the opinion of management, the accompanying unaudited condensed consolidated financial statements and notes contain all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the Company s financial position, results of operations and cash flows at the dates and for the periods indicated. The operating results for the three months ended March 31, 2003 are not necessarily indicative of the results to be expected for the full year ending December 31, 2003.

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

(2) STOCKHOLDERS EQUITY

Stock-Based Compensation

ATG grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. ATG accounts for stock-based compensation for employees in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related Interpretations, and follows the disclosure-only alternative under FAS 123, *Accounting for Stock Based Compensation.*

Had compensation expense for ATG s Stock Plans been recorded consistent with FAS 123, the pro forma net loss per share would have been as follows (in thousands):

	Three Months Ended March 31,	
	2003	**2002**
Net loss as reported	$ (2,754)	$ (2,849)
Add: Stock-based employee compensation expense included in reported net loss	81	271
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards	(14,107)	(15,356)
Pro forma net loss	$ (16,780)	$ (17,934)
Basic and diluted net loss per share		
As reported	$ (0.04)	$ (0.04)
Pro forma	$ (0.24)	$ (0.26)

Increase in shares available under option plans

During the three months ended March 31, 2003, the Company s Board of Directors approved resolutions, subject to shareholder approval, to increase the number of shares of common stock available for future issuances under the 1999 Outside Director s Stock Option Plan and the 1999 Employee Stock Purchase Plan to 800,000 shares from 300,000 shares, and to 5,000,000 shares from 3,000,000 shares, respectively.

Option Exchange Program

On August 1, 2002, the Company offered all full-time and part-time employees, other than the officers as defined in Rule 16a-1(f) of the Securities and Exchange Act of 1934, and directors, the opportunity to participate in a stock option exchange program. The voluntary program gave employees the opportunity to exchange options with exercise prices of $15.00 or more per share that were granted under the Amended and Restated 1996 Stock Option Plan. However, if an employee elected to cancel any awards, all options granted after January 26, 2002 were also required to be canceled and the employee could not be granted any additional shares of stock before March 3, 2003. The new options were exercisable for one share of ATG s common stock for every three shares of the Company s common stock issuable upon exercise of a surrendered option to be granted at least six months and one day after the old options were cancelled. Approximately 3,000,495 options were eligible for exchange under this program.

On August 29, 2002, 1,997,819 options were cancelled under the stock option exchange program. On March 3, 2003, 479,447 replacement options were granted to employees of ATG in accordance with the Option Exchange Program, at a grant price of $0.99 per share. Twenty-five percent of each new option vested immediately on the date of grant. The remaining seventy-five percent will vest in three equal installments in six-month intervals.

(3) 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) 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) by the weighted average number of shares of common stock outstanding, plus the dilutive effect of common stock equivalents, which consist of stock options using the treasury stock method.

The following table sets forth basic and diluted net income (loss) per share computational data for the three months ended March 31, 2003 and 2002 (in thousands, except per-share amounts):

	Three Months Ended March 31,	
	2003	**2002**
Net loss	$ (2,754)	$ (2,849)
Weighted average common shares outstanding used in computing basic net loss per share	70,982	69,494
Weighted average common equivalent shares outstanding:		
Employee common stock options		
Total weighted average common stock and common stock equivalents outstanding used in computing diluted net loss per share	70,982	69,494
Basic net loss per share	$ (0.04)	$ (0.04)
Diluted net loss per share	$ (0.04)	$ (0.04)
Antidilutive common stock equivalents	12,514	14,065

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(4) 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 of selling products and services, separately, 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 and apply the residual method under Statement of Position 98-9.

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. Revenue earned on software arrangements involving multiple elements which qualify for separate element accounting treatment is allocated to each undelivered element using the relative fair values of those elements based on vendor specific objective evidence with the remaining value assigned to the delivered element, the software license. Typically, the Company s software licenses do not include significant post-delivery obligations to be fulfilled by the Company and payments are due within a three-month period from the date of delivery. Consequently, license fee revenue is generally recognized when the product is shipped. Revenues from software maintenance agreements are recognized ratably over the term of the maintenance period, which is typically one year. ATG enters into reseller arrangements that typically provide for sublicense fees payable to ATG based upon a percentage of ATG s list price. Revenues are recognized under reseller agreements as earned for guaranteed minimum royalties, generally ratably over one year, 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. Unbilled services represent service revenues that have been earned by ATG in advance of billings. Amounts collected or billed prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Deferred revenue primarily consists of advance payments related to support and maintenance and service agreements.

(5) CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

ATG accounts for investments in marketable securities under FAS 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115). Under FAS 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 maturities at the date of acquisition of less than 90 days. Marketable securities are investment grade debt securities with maturities at the date of acquisition of greater than ninety days. At March 31, 2003 and December 31, 2002, all of ATG s marketable securities were held in commercial paper and corporate bonds and were classified as held-to-maturity, and have maturities that are less than one year. The average maturity of ATG s marketable securities was approximately 3.6 months at March 31, 2003 and December 31, 2002, respectively. At March 31, 2003, and December 31, 2002, the difference between the amortized cost and market value of ATG s marketable securities was approximately $(19,000) and $(21,000), respectively. Realized gains and losses for the three months ended March 31, 2003 and 2002 were not material. At March 31, 2003 and December 31, 2002, ATG s cash, cash equivalents and marketable securities consisted of the following:

	March 31, 2003	December 31, 2002
	(In thousands)	
Cash and cash equivalents		
Cash	$36,993	$39,130
Money market accounts	12,029	6,699
Total cash and cash equivalents	$49,022	$45,829
Marketable securities		
Corporate securities	$17,617	$22,729

Total marketable securities	$17,617	$22,729

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(6) COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended March 31,	
	2003	2002
	(In thousands)	
Net loss	$(2,754)	$(2,849)
Foreign currency translation loss	(280)	(32)
Comprehensive loss	$(3,034)	$(2,881)

The accumulated other comprehensive loss at March 31, 2003 and December 31, 2002, of $1,991,000 and $1,711,000 respectively, consisted entirely of the cumulative foreign currency translation adjustment.

(7) DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE

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

Revenues from sources outside of the United States were approximately $4.8 million and $7.8 million for the three months ended March 31, 2003 and 2002, respectively. ATG s revenue from international sources was primarily generated from customers located in Europe and Asia/Pacific. All of ATG s software licenses for the three months ended March 31, 2003 and 2002 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 the three months ended March 31, 2003 and 2002:

Three Months Ended March 31,