ART TECHNOLOGY GROUP INC
Form 10-K
March 17, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-K

(Mark One)

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

Commission file number 000-26679

Art Technology Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**04-3141918** *(I.R.S. Employer Identification No.)*
One Main Street **Cambridge, Massachusetts** *(Address of principal executive offices)*	**02142** *(Zip Code)*

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value with Associated Preferred Stock Purchase Rights	**The Nasdaq Stock Market, LLC**

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

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

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

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 þ No o

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

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

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

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

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

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

Documents Incorporated by Reference

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

ART TECHNOLOGY GROUP, INC.

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

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PART I

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

Item 1. *Business*

Our Business

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

Corporate Information

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

Overview

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

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

We market our products and services primarily to Global 2000 companies and other businesses that have large numbers of online users and utilize the Internet as an important business channel. We focus primarily on providing our software and services to businesses in the retail, consumer products, manufacturing, media and entertainment, telecommunications, financial services, travel and insurance industries. We have over 900 customers, including Amazon, American Eagle Outfitters, American Express, AOL, AT&T, Best Buy, B&Q, Cabela s, Carrefour, Cingular, Coca Cola, Continental Airlines, Dell, DirecTV, El Corte Ingles, Expedia, France Telecom, Harvard Business School Publishing, Hewlett-Packard, Intuit, Hilton, HSBC, L.L Bean, Macy s, Meredith, Microsoft,

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

Our business has evolved significantly since our incorporation in 1991:

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

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

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

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

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

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

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

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

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

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

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

Our Strategy

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

Deliver a commerce platform with leadership functionality, suitable for the most demanding enterprises. Our clients tell us that, in some cases, our platform handles over 100,000 orders per day in peak periods. Leading industry analysts rank our overall offering number one among commerce platforms for business-to-consumer sites on criteria, including reliability and scalability, administration and management, catalog/content management, campaign management and customer self-service. It is our objective to continue to provide leadership in e-commerce functionality and operational excellence.

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

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

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

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

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

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

ATG Licensed Software Products

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

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

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

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

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

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

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

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

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

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

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

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

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

Our products allow companies to present a single view of themselves to their customers through our repository integration. This integration technology is designed to allow companies to easily access and utilize data in the enterprise regardless of the data storage format or location. The data can be leveraged in native form without having to move, duplicate or convert the data. By enabling these capabilities in a cost-effective manner, we believe our products can help companies protect their brands and keep their customers from becoming confused or frustrated, all of which positively impact customer satisfaction and loyalty.

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

Recurring Revenue

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

eStara e-Commerce Optimization Services Offerings

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

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

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

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

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

ATG OnDemand

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

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

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

shifting the client s technology risks to us;

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

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

Customer Support and Maintenance Services

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

Professional and Educational Services Revenue

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

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

> *OnDemand Offerings.* By leveraging our experience with the pre-built OnDemand offerings, our Professional Services organization assists our clients with their implementations, thus helping our clients quickly and economically launch their e-commerce and service projects.
>
> *Full-lifecycle Solutions.* We work with our clients from the earliest stages of their projects. The full-lifecycle approach encompasses everything from working with our clients end users and technical staff to define project requirements to solution design, implementation, usability testing, staging and deployment.
>
> *Custom Solutions.* We can also manage specific areas of our clients projects, such as designing a solution to meet a client s requirements, implementing scenarios or integrating our solutions with a third-party application.
>
> *Structured Enablement.* In this model, we give our clients the guidance they need while maximizing the skills of the clients own personnel. Depending on a client s project goals and the expertise of its team, appropriate ATG personnel (such as architects or engineers) work onsite as advisors to aid the client s personnel in areas such as reviewing completed work or advising on a particular project area.

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

Markets

Our principal target markets are Global 2000 companies and other businesses that have large numbers of online users and utilize the Internet as an important business channel. Our clients represent a broad spectrum of enterprises within diverse industry sectors, and include some of the world s leading corporations. As of December 31, 2007, we had more than 900 customers.

Research and Development

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

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

Sales and Marketing

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

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

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

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

Strategic Alliances

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

Competition

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

- in-house development efforts by potential clients or partners;
- e-commerce application vendors, such as Escalate Retail and IBM;
- e-commerce business process outsourcers, such as Digital River and GSI Commerce;

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

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

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

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

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

Proprietary Rights and Licensing

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

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

Employees

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

Internet Address and SEC Reports

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

Our Internet website is www.atg.com. We make available, free of charge, on or through our Internet website our Period Reports and amendments to those Periodic Reports as soon as reasonably practicable after we electronically file them with the Commission. We are not, however, including the information contained on our website, or information that may be accessed through links on our website, as part of, or incorporating it by reference into, this annual report on Form 10-K.

Item 1A. *Risk Factors*

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

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

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

- the timing of revenue recognition of our products and services, which is affected by the mix of product license revenue and services provided; due to the growth of our service offerings and evolution of our sales terms with our customers, an increasing portion of our revenue is being recognized ratably over a period of time rather than at the time of invoice and we expect this trend to continue in the near term;
- the timing of customer orders, especially larger transactions, and product implementations;
- Our ability to cultivate and maintain strategic alliances;
- fluctuating economic conditions, particularly as they affect our customers willingness to implement new e-commerce solutions and their ability to pay for our products and services;
- delays in introducing new products and services;
- the size of price discounting and concessions;
- changes in the mix of revenues derived from products and services;
- timing of hiring and utilization of personnel;
- cost overruns related to fixed-price services projects;
- the mix of domestic and international sales;
- variation in our actual costs from our cost estimates related to long term hosting contracts;
- increased expenses, whether related to sales and marketing, product development or administration; and
- costs related to possible acquisitions of technologies or businesses.

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

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

We operate in a rapidly evolving industry, which makes it more difficult to predict our future operating results. We cannot be certain that our revenues will grow or our expenses will decrease at rates that will allow us to achieve profitability on a quarterly or annual basis. Additionally, we expect to recognize an increasing portion of our revenue ratably over a period of time rather than at the time invoice. In the near term, this may have an adverse effect on our revenue and net income, which could result in a decline in the price of our common stock.

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

We have a long sales cycle, often several months or quarters, because our clients often need to make large expenditures and invest substantial resources in order to take advantage of our products and services and also because we generally need to educate potential customers about the use and benefits of our products and services. This long sales cycle makes it difficult to predict the quarter in which sales may occur. We may incur significant sales and marketing expenses in anticipation of selling our products, and if we do not achieve the level of revenues we expected, our operating results will suffer and our stock price may decline. Further, our potential customers frequently need to obtain approvals from multiple decision makers before making purchase decisions. Delays in sales could cause significant variability in our revenues and operating results for any particular period.

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

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

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

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

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

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

To succeed, we need to enhance our current products and develop new products on a timely basis to keep pace with market needs, satisfy the increasingly sophisticated requirements of customers and leverage strategic alliances with third parties in the e-commerce field who have complementary or competing products. E-commerce technology is complex, and new products and product enhancements can require long development and testing periods. Any delays in developing and releasing new or enhanced products could cause us to lose revenue opportunities and customers.

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

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

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

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

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

Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to enhance their products and expand their markets. Accordingly, new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

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

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

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

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

Our OnDemand hosted services and our eStara e-commerce optimization services are at an early stage of development and any equipment failures, mechanical errors, spikes in usage volume or failure to follow system protocols and procedures could cause our systems to fail, resulting in interruptions in our clients   service to their customers. Any such interruptions or delays in our hosting services, whether as a result of third-party error, our own error, natural disasters or accidental or willful security breaches, could harm our relationships with clients and our reputation. This in turn could reduce our revenue, subject us to liability, cause us to issue credits or pay penalties or cause our clients to decide not to renew their hosting agreements, any of which could adversely affect our business, financial condition and results of operations.

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

Our success depends on our ability to attract, motivate and retain skilled personnel, especially in the areas of management, finance, sales, marketing and research and development, and we compete with other companies for a small pool of highly qualified employees. Members of our management team, including executives with significant responsibilities in these areas, have left us during the past few years for a variety of reasons, and there may be additional departures in the future. These historical and potential future changes in personnel may be disruptive to our operations or affect our ability to maintain effective internal controls over financial reporting. In addition, equity incentives such as stock options constitute an important part of our total compensation program for employees, and the volatility or lack of positive performance of our stock price may adversely affect our ability to retain our employees or hire replacements.

If we fail to anticipate and address the risks associated with CleverSet s business, then our business could be harmed.

The integration of the business and operations of CleverSet, which we acquired in February 2008, into our business and operations is an important process. In order to be successful, we need to retain key CleverSet personnel and also understand and address the risks associated with CleverSet s business and products. For example, it is possible that the market for CleverSet s products may be more limited than we anticipated or that CleverSet s technology may infringe upon a third party s intellectual property. If we fail to successfully integrate CleverSet s business and operations, retain valuable CleverSet personnel and address the risks associated with our acquisition of its business, then we could fail to realize the anticipated benefits of the acquisition, and the disruption caused by the acquisition could hurt our business.

We could incur substantial costs defending against a claim of infringement or protecting our intellectual property from infringement.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. Companies providing Internet-related products and services are increasingly bringing and becoming subject to suits alleging infringement of proprietary rights, particularly patent rights. We could incur substantial costs in prosecuting or defending any intellectual property litigation. If we sue to enforce our rights or are sued by a third party that claims that our technology infringes its rights, the litigation could be expensive and could divert our management resources. For example, both we and our Primus subsidiary have been involved in litigation alleging that we have infringed United States patents owned by third parties. We may be required to incur substantial costs in defending infringement litigation in the future, which could have a material adverse effect on our operating results and financial condition.

In addition, we have agreed to indemnify customers against claims that our products infringe the intellectual property rights of third parties. From time to time, our customers have been subject to third party patent claims and we have agreed to indemnify these customers to the extent the claims related to our products. 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.

We seek to protect the source code for our proprietary software under a combination of patent, copyright and trade secrets law. 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.

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, we expect software piracy 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

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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. If we fail to meaningfully protect our intellectual property, then our business, operating results and financial condition could be materially harmed.

Finally, our professional services may 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.

If we fail to maintain our existing customer base, then our ability to generate revenues will be harmed.

Historically, we have derived a significant portion of our revenues from existing customers that purchase our support and maintenance services and license enhanced versions of our products. If we are unable to continue to obtain significant revenues from our existing customer base, then our ability to grow our business would be harmed, and our competitors could achieve greater market share. The current trend toward e-commerce replatforming may increase this risk. When existing ATG customers re-evaluate their e-commerce platforms and solutions, they may elect to replace our e-commerce solutions with those of other vendors. If they do, these customers, as well as other prospective customers who choose e-commerce solutions other than ours in connection with their replatforming, are likely to commit substantial expenditures and investments of time and resources to the implementation of the e-commerce solution included in their new chosen platforms, reducing the probability that we will be able to penetrate those accounts in the near future.

If we fail to address the challenges associated with our international operations, then revenues from our products and services may decline, and the costs of providing our products or services may increase.

At December 31, 2007, we had offices in the United Kingdom, France, Northern Ireland, Canada and Singapore. We derived 32% of our total revenues in 2007 and 25% of our total revenues in 2006 from customers outside the United States. Our operations outside the United States are subject to additional risks, including:

- changes in regulatory requirements, exchange rates, tariffs and other barriers;
- longer payment cycles and problems in collecting accounts receivable in Western Europe and Asia;
- difficulties in managing systems integrators and technology partners;
- difficulties in staffing and managing foreign subsidiary operations;
- differing technology standards;
- difficulties and delays in translating products and product documentation into foreign languages for countries in which English is not the primary language;
- reduced protection for intellectual property rights in some of the countries in which we operate or plan to operate;
- difficulties related to entering into legal contracts under local laws and in foreign languages;
- fluctuations in the exchange rates between foreign and United States currency;

potentially adverse tax consequences; and

political and economic instability.

We may need financing in the future, and any additional financing may result in restrictions on our operations or substantial dilution to our stockholders.

We may need to raise funds in the future, for example, to develop new technologies, expand our business, respond to competitive pressures, acquire complementary businesses or respond to unanticipated situations. We may try to raise additional funds through public or private financings, strategic relationships or other arrangements.

Our ability to obtain debt or equity funding will depend on a number of factors, including market conditions, our operating performance and investor interest. Additional funding may not be available to us on acceptable terms or at all. If adequate funds are not available, we may be required to reduce expenditures, including curtailing our growth strategies, foregoing acquisitions or reducing our product development efforts. If we succeed in raising additional funds through the issuance of equity or convertible securities, then the issuance could result in substantial dilution to existing stockholders. If we raise additional funds through the issuance of debt securities or preferred stock, these new securities would have rights, preferences and privileges senior to those of the holders of our common stock. The terms of these securities, as well as any borrowings under our credit agreement, could impose restrictions on our operations.

If systems integrators or value added resellers reduce their support and implementation of our products, then our revenues may fail to meet expectations and our operating results would suffer.

Since our potential customers often rely on third-party systems integrators to develop, deploy and manage websites for conducting commerce on the Internet, we cultivate relationships with systems integrators to encourage them to support our products. We do not, however, generally have written agreements with our systems integrators, and they are not required to implement solutions that include our products or to maintain minimum sales levels of our products. Our revenues would be reduced if we fail to train a sufficient number of systems integrators adequately or if systems integrators devote their efforts to integrating or co-selling products of other companies. Any such reduction in revenue would not be accompanied by a significant offset in our expenses. As a result, our operating results would suffer, and the price of our common stock would probably fall.

If our software products contain serious errors or defects, then we may lose revenues and market acceptance and may incur costs to defend or settle product liability claims.

Complex software products such as ours often contain errors or defects, particularly when first introduced or when new versions or enhancements are released. Despite internal testing and testing by our customers, our current and future products may contain serious defects, which 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 and could seriously damage our reputation in the marketplace, making it harder for us to sell our products.

Government or industry regulations could directly restrict our business or indirectly affect our business by limiting the growth of e-commerce.

As e-commerce evolves, federal, state and foreign agencies have adopted and could in the future adopt regulations covering issues such as user privacy, content and taxation of products and services. Government regulations could limit the market for our products and services or 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 has generated privacy concerns that could result in legislation or market perceptions that could result in reduced sales of our products and harm our business.

Businesses use our ATG Adaptive Scenario Engine product to develop and maintain profiles to tailor the content to be provided to website visitors. When a visitor first arrives at a website, our software creates a profile for that visitor. If the visitor registers or logs in, the visitor s identity is added to the profile, preserving any profile information that was gathered up to that point. ATG Adaptive Scenario Engine product tracks both explicit user profile data supplied by the user as well as implicit profile attributes derived from the user s behavior on the website. Privacy concerns may cause visitors to resist providing the personal data or to avoid websites that track the web behavioral information necessary to support our 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 website users that the data captured after visiting websites 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, and the United States may follow suit. Privacy legislation and consumer privacy concerns could make it harder for us to sell our products and services, resulting in reduced revenues.

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. The user can generally remove the cookies, 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, then demand for our personalization products could be reduced.

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 charter and by-laws may discourage, delay or prevent a merger or acquisition that some of our stockholders 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 and prohibiting stockholder action by written consent;
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings; and
- authorizing anti-takeover provisions.

In addition, we adopted a shareholder rights plan in 2001. The existence of our shareholder rights plan, as well as certain provision of Delaware law may further discourage, delay or prevent someone from acquiring or merging with us.

Continued compliance with regulatory and accounting requirements will be challenging and will require significant resources.

We are spending a significant amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission rules and regulations and NASDAQ Global Market rules. In particular, Section 404 of the Sarbanes-Oxley Act of 2002 requires management s annual review and evaluation of internal control over financial reporting. The process of documenting and testing internal control over

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financial reporting has required that we hire additional personnel and outside services and has resulted in higher accounting and legal expenses. While we invested significant time and money in our effort to evaluate and test our internal control over financial reporting, a material weakness was identified in our internal control over financial reporting in 2006. Although the material weakness was remediated in 2007, there are inherent limitations to the effectiveness of any system of internal controls and procedures, including cost limitations, the possibility of human error, judgments and assumptions regarding the likelihood of future events, and the circumvention or overriding of the controls and procedures. Accordingly, even effective controls and procedures can provide only reasonable assurance of achieving their control objectives.

Item 1B. ***Unresolved Staff Comments***

On December 21, 2007, we received a comment letter from the staff of the United States Securities and Exchange Commission (the Staff). We submitted a response to the Staff on January 29, 2008. On March 13, 2008, we received a second letter from the Staff, seeking additional clarification concerning one of our responses. The unresolved Staff comment concerns the methodology we used in our financial statements included in our 2006 Form 10-K and third quarter 2007 Form 10-Q for allocating and classifying revenue derived from multi-element arrangements between product license revenue and service revenue. The ultimate resolution will not have any impact on our total revenue or profits in any fiscal year or quarter previously reported nor will it have any impact on our future total revenue or profits. We are in the process of responding to the Staff s request for future clarification.

Item 2. ***Properties***

Our headquarters are located in 45,000 square feet of leased office space in Cambridge, Massachusetts. In addition, we have major United States facilities in Seattle, Washington (approximately 9,000 square feet); Chicago, Illinois (approximately 6,000 square feet); San Francisco, California (approximately 3,000 square feet); Reston, Virginia (approximately 10,000 square feet) and Washington, D.C. (approximately 7,000 square feet). Our European headquarters are located in Apex Plaza, Reading, United Kingdom where we lease approximately 8,000 square feet. We also maintain offices in Northern Ireland, Canada, France and Singapore. All of our facilities are leased. We believe our facilities are sufficient to meet our needs for the foreseeable future and, if needed, additional space will be available at a reasonable cost.

Item 3. ***Legal Proceedings***

As previously disclosed, in 2001, we were named as defendants in seven purported class action suits that were consolidated into one action in the United States District Court for the District of Massachusetts under the caption In re Art Technology Group, Inc. Securities Litigation. The action alleges that we, and certain of our former officers, violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated there under. In October 2006, the court ruled in our favor and dismissed the case on summary judgment. The plaintiffs have appealed the decision. The parties have filed appeal briefs and we expect that oral arguments will be presented in 2008. Management believes that none of the claims that plaintiffs have asserted have merit, and we intend to continue to defend the action vigorously. While we cannot predict with certainty the outcome of the litigation or the appeal, we do not expect any material adverse impact to our business, or the results of our operations, from this matter.

As previously disclosed, in December 2001, a purported class action complaint was filed against our wholly owned subsidiary Primus Knowledge Solutions, Inc., two former officers of Primus and the underwriters of Primus 1999 initial public offering. The complaints are similar and allege violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934 primarily based on the allegation that the underwriters received undisclosed compensation in connection with Primus initial public offering. The litigation has been consolidated in the United States District Court for the Southern District of New York (SDNY) with claims against approximately 300 other companies that had initial public offerings during the same general time period. In February 2005, the court issued an opinion and order granting preliminary approval of a proposed settlement, subject to certain non-material modifications. However in June 2007, the court terminated the settlement process due to the parties inability to certify the settlement class. Plaintiffs counsel are seeking certification of a narrower class of plaintiffs and filed amended complaints in September 2007. We believe we have meritorious defenses and intend to defend the case vigorously. While we cannot predict the outcome of the litigation, we do not expect any material adverse impact to our business, or the results of our operations, from this matter.

Our industry is characterized by the existence of a large number of patents, trademarks and copyrights, and by increasingly frequent litigation based on allegations of infringement or other violations of intellectual property rights. Some of our competitors in the market for e-commerce software and services have filed or may file patent applications covering aspects of their technology that they may claim our technology infringes. Such competitors could make claims of infringement against us with respect to our products and technology. Additionally, third parties who are not actively engaged in providing e-commerce products or services but who hold or acquire patents upon which they may allege our current or future products or services infringe may make claims of infringement against us or our customers. Our agreements with our customers typically require us to indemnify them against claims of intellectual property infringement resulting from their use of our products and services. We periodically receive notices from customers regarding patent licence inquiries they have received which may or may not implicate our indemnity obligations, and we and certain of our customers are currently parties to litigation in which it is alleged that the patent rights of others are infringed by our products or services. Any litigation over intellectual property rights, whether brought by us or by others, could result in the expenditure of significant financial resources and the diversion of management s time and efforts. In addition, litigation in which we or our customers are accused of infringement might cause product shipment or service delivery delays, require us to develop alternative technology or require us to enter into royalty or license agreements, which might not be available on acceptable terms, or at all. We could incur substantial costs in prosecuting or defending any intellectual property litigation. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, require expensive changes in our methods of doing business or could require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

The ultimate outcome of any litigation is uncertain, and either unfavorable or favorable outcomes could have a material negative impact on our results of operations, consolidated balance sheets and cash flows, due to defense costs, diversion of management resources and other factors.

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

None.

PART II

Item 5. *Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Our common stock trades on The NASDAQ Global Market (formerly known as The NASDAQ National Market) under the symbol ARTG. 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 Global Market.

	High	Low
Fiscal 2006		
First quarter	$ 3.49	$ 1.83
Second quarter	3.81	2.12
Third quarter	3.10	2.32
Fourth quarter	2.66	1.91

Fiscal 2007		
First quarter	$ 2.67	$ 2.04
Second quarter	2.88	2.19
Third quarter	3.33	2.69
Fourth quarter	4.75	3.10

On March 10, 2008 the last reported sale price on The NASDAQ Global Market for our common stock was $3.18 per share. On March 10, 2008, there were approximately 606 holders of record of our common stock. This number does not include stockholders for whom our shares were held in a nominee or street name.

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We have never paid or declared any cash dividends on shares of our common stock or other securities and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain all future earnings, if any, for use in the operation of our business.

The following graph compares the cumulative total stockholder return on our common stock during the period December 31, 2002 to December 31, 2007 with the cumulative total return of the NASDAQ Market Index and a peer group index over the same period. This comparison assumed the investment of $100 on December 31, 2002 in our common stock, the NASDAQ Market Index and the peer group index and assumes dividends, if any, are reinvested. The peer group index that we used is Hemscott Industry Group 852 (Internet Software and Services), which reflects the stock performance of 70 publicly traded companies in the Internet software and services marketplace.

	Value of Investment($)					
	12/31/2002	**12/31/2003**	**12/31/2004**	**12/31/2005**	**12/29/2006**	**12/31/2007**
Art Technology Group Inc.	$ 100.00	$ 123.39	$ 120.97	$ 158.06	$ 187.90	$ 348.39
Internet Software & Svcs	$ 100.00	$ 200.13	$ 252.24	$ 218.28	$ 207.19	$ 221.50
NASDAQ Market Index	$ 100.00	$ 150.36	$ 163.00	$ 166.58	$ 183.68	$ 201.91

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Stock Repurchase Program

On April 19, 2007 our Board of Directors authorized a stock repurchase program providing for repurchases of our outstanding common stock of up to $20 million, in the open market or in privately negotiated transactions, at times and prices considered appropriate depending on prevailing market conditions. During the year ended December 31, 2007, we repurchased 986,960 shares of our common stock at a cost of $2.9 million.

Our stock repurchase authorization does not have an expiration date and the pace of our repurchase activity will depend on factors such as our working capital needs, our cash requirements for acquisitions, any debt repayment obligations which may arise, our stock price, and economic and market conditions. Our stock repurchases may be effected from time to time through open market purchases or pursuant to a Rule 10b5-1 plan. Our stock repurchase program may be accelerated, suspended, delayed or discontinued at any time.

The table below presents information regarding our repurchases of our common stock during the three months ended December 31, 2007.

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plan	(d) Approximate dollar value of shares that may yet be purchased under the plans or programs (In thousands)
November 2007	171,300	$ 4.15	171,300	$ 17,098

Item 6. *Selected Consolidated Financial Data*

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and with Management s Discussion and Analysis of Financial Condition and Results of Operations and other financial data included elsewhere in this Annual Report on Form 10-K. Except as set forth below, the consolidated statement of operations data and balance sheet data for all periods presented are derived from audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K or in Annual Reports on Form 10-K for prior years on file with the United States Securities and Exchange Commission.

On January 1, 2006, we adopted, on a modified prospective basis, the provisions of SFAS No. 123(R), which requires us to record stock-based compensation expense for employee stock awards at fair value at the time of grant. Stock-based compensation expense was $5.8 million and $3.8 million for the years ended December 31, 2007 and 2006, respectively.

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Consolidated Statement of Operations Data:

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per share data)				
Revenue:					
Product licenses	$ 30,529	$ 32,784	$ 29,821	$ 23,345	$ 26,793
Recurring services	76,672	51,113	44,258	29,359	31,266
Professional and education services	29,859	19,335	16,567	16,515	14,047
Total revenue	137,060	103,232	90,646	69,219	72,106
Cost of Revenue:					
Product licenses	2,197	1,751	1,816	2,206	2,118
Recurring services	24,119	11,239	6,575	3,884	4,689
Professional and education services	29,223	19,560	16,680	15,995	15,041
Total cost of revenue	55,539	32,550	25,071	22,085	21,848
Gross Profit	81,521	70,682	65,575	47,134	50,258
Operating Expenses:					
Research and development	24,963	21,517	18,481	16,209	17,928
Sales and marketing	44,397	30,909	29,396	29,602	31,400
General and administrative	18,211	12,952	11,231	7,742	9,265
Restructuring charge (benefit)	(59)	(62)	885	3,570	(10,346)
Total operating expenses	87,512	65,316	59,993	57,123	48,247
Income (loss) from operations	(5,991)	5,366	5,582	(9,989)	2,011
Interest and other income, net	2,237	1,712	219	395	176
Income (loss) before provision (benefit) for income taxes	(3,754)	7,078	5,801	(9,594)	2,187
Provision (benefit) for income taxes	433	(2,617)	32	(50)	(255)
Net income (loss)	$ (4,187)	$ 9,695	$ 5,769	$ (9,544)	$ 2,442
Basic net income (loss) per share	$ (0.03)	$ 0.08	$ 0.05	$ (0.12)	$ 0.03
Diluted net income (loss) per share	$ (0.03)	$ 0.08	$ 0.05	$ (0.12)	$ 0.03
Basic weighted average common shares outstanding	127,528	115,280	109,446	79,252	71,798
Diluted weighted average common shares outstanding	127,528	120,096	111,345	79,252	73,678

Consolidated Balance Sheet Data:

	December 31, 2007	2006	2005	2004	2003
	(In thousands)				
Cash, cash equivalents and short-term marketable securities	$ 50,879	$ 31,223	$ 33,569	$ 26,507	$ 41,584
Long-term marketable securities	1,062			4,001	
Total assets	177,719	149,981	92,765	97,803	67,360
Total deferred revenue	46,354	24,209	21,113	25,355	14,915
Long-term obligations, less current maturities			63	112	
Total stockholders equity	$ 107,097	$ 105,074	$ 50,160	$ 42,185	$ 20,937

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Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

Overview

This Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our consolidated financial statements and notes thereto which appear elsewhere in this Annual Report on Form 10-K. See Risk Factors elsewhere in this Annual Report on Form 10-K for a discussion of certain risks associated with our business. The following discussion contains forward-looking statements. The forward-looking statements do not include the potential impact of any mergers, acquisitions, or divestitures of business combinations that may be announced after the date hereof.

We develop and market a comprehensive suite of e-commerce software products, as well as provide related services in conjunction with our products, including support and maintenance, professional services, managed application hosting services, eStara e-commerce optimization services solutions for enhancing online sales and support. We primarily derive revenue from the sale of software products and related services. Our software licenses are priced based on the size of the customer implementation. Services revenue is derived from fees for recurring services, professional services and education services. Our recurring services revenue is comprised of managed application hosting services, eStara e-commerce optimization service solutions and support and maintenance. Managed application hosting revenue is recognized monthly as the services are provided based on a per transaction, per CPU or percent of customer s revenue basis. eStara e-commerce optimization service solutions are priced on a per transaction basis and recognized monthly as the services are provided. Support and maintenance arrangements are priced based on the level of support services provided as a percent of net license fees per annum. Under support and maintenance services, customers are generally entitled to receive software upgrades and updates, maintenance releases and technical support. Professional and educational service revenue includes implementation, custom application development, technical consulting and educational training. We bill professional service fees primarily on a time and materials basis. Education services are billed as services are provided.

Shift to increasing ratably recognized revenue

Before 2007, most of our revenue from arrangements involving the sale of our software was derived from perpetual software licenses and was recognized at the time the license agreement was executed and delivery of the software occurred provided that the other criteria of revenue recognition was met. Beginning in the first quarter of 2007, a significant number of our perpetual software licenses also included the sale of our eStara e-commerce optimization services solutions or managed application hosting services. As a result of applying the requirements of U.S. generally accepted accounting principles (GAAP) to our evolving business model, the revenue from an increasing number of our arrangements is being recognized on a ratable basis over the estimated term of the contract or arrangement.

The addition of eStara e-commerce optimization services and managed application hosting services solution offerings introduced new products in our portfolio for which we do not have vendor specific objective evidence of fair value. As a result, when we sell eStara e-commerce optimization services solutions and managed application hosting services in conjunction with e-commerce software, we defer all fees incurred prior to the delivery of the service solutions and recognize the fees as revenue ratably over either the term of the contract or estimated life of the arrangement depending on the specific facts of the arrangement.

In the longer term, we expect this transition to result in greater stability and predictability in our revenues, and a pattern of growth in our total GAAP revenue over any current period that is more reflective of our level of business activity in that period. In the interim, however, the effect of this shift in our business model has been to adversely affect our near term revenue growth and net income.

Key measures that we use to evaluate our performance:

The change to our business model has required our management to re-consider the measures that we use to evaluate our business results. In addition to the traditional measures of financial performance that are reflected in our results of operations determined in accordance with GAAP, we also monitor certain non-GAAP financial measures of the performance of our business. A non-GAAP financial measure is a numerical measure of a

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company s historical or future financial performance that excludes amounts that are included in the most directly comparable measure calculated and presented in the GAAP statement of operations. Among the GAAP and non-GAAP measures that we believe are most important in evaluating the performance of our business are the following:

We use net income and gross margins on our recurring services revenue and professional services and education services revenue, to measure our success at meeting cash and non-cash cost and expense targets in relation to revenue earned.

We use product license bookings, a non-GAAP financial measure, as an important measure of growth in demand for our ATG e-commerce platform and the success of our sales and marketing efforts. We define product license bookings as product license revenue as reported on our statement of operations plus the contract value of licenses executed in the current period less revenue that was recognized from licenses executed in prior periods. We believe that this measure provides us with an indication of the amount of new software license business that our direct sales team has added in the period. Product license revenue associated with a particular transaction may be deferred for reasons other than the presence of a managed application hosting or eStara e-commerce optimization solutions arrangement, such as the presence of credit risk or other contractual terms that, under GAAP, require us to defer the recognition of revenue. The deferred revenue for such a transaction may be recognized in a single future period when the conditions that originally required deferral have been resolved, rather than ratably. We include all additions to deferred product license revenue in our calculation of product license bookings.

We use cash flow from operations as an indicator of the success of the business. Because a significant portion of our revenue is deferred, in the near term our net income may be significantly different from the cash that we generate from operations. Cash flow from operations is typically higher in the quarters following our seasonally stronger product license bookings quarters, which have historically been the fourth and second quarters.

We use recurring services revenue, as reported on our statement of operations, to evaluate the success of our strategy to deliver site-independent online services and the growth of our ratable revenue sources. We expect that recurring services revenue will continue to increase as a percentage of total revenue in future periods. Recurring services revenue includes eStara e-commerce optimization services solutions, application hosting services and support and maintenance related to ATG e-commerce platform sales.

We use days sales outstanding (DSO), calculated by dividing accounts receivable in the period by revenue and multiplying the result by the number of days in the period. We also use a modified DSO that adjusts our revenue by the change in deferred revenue during the period to provide us with a more accurate picture of the strength of our accounts receivables and related collection efforts. The percentage of accounts receivable that are less than 60 days old is an important factor that our management uses to understand the strength of our accounts receivable portfolio. This measure is important because a disproportionate percentage of our product license bookings often occurs late in the quarter, which has the effect of increasing our DSO and modified DSO.

Trends in On-Line Sales and our Business

Set forth below is a discussion of recent developments in our industry that we believe offer us significant opportunities, present us with significant challenges, and have the potential to significantly influence our results of operations.

Trend in on-line sales. The growth of e-commerce as an important sales channel is the principal driver for demand for our products and services. According to Forrester Research and Gartner, e-commerce sales grew 21% to $175 billion in 2007 and they are projected to grow to $335 billion by 2012. Online holiday sales grew 19% in 2007, five times the rate of growth for offline stores. As online sales continue to outpace store growth and the importance of this channel grows, we believe that retailers require more sophisticated e-commerce solutions in order to stay competitive on-line and increase conversion rates, order size and revenue.

E-commerce replatforming. Enterprises periodically upgrade or replace the network and enterprise applications software and the related hardware systems that they use to run their e-commerce operations in order to take advantage of advances in computing power, system architectures and enterprise software functionality that enable them to increase the capabilities of their e-commerce systems while simplifying operation and maintenance of these systems and reducing their cost of ownership. In the e-commerce software industry, we refer to these major system upgrades or replacements as replatforming. We believe that on average, customers in our market replatform or refresh their e-commerce software approximately every five years. In large part due to the increased significance of the on-line sales channel, industry analysts believe that e-commerce is currently in a period of increased replatforming activity, with increased corporate spending on e-commerce solutions across many of our markets.

Emergence of the on demand model of Software as a Service. An important trend throughout the enterprise software industry in recent years has been the emergence of Software as a Service , or SaaS. SaaS is a software delivery model whereby a software vendor that has developed a software application hosts and operates it for use by its customers over the Internet. The emergence of SaaS has been driven by customers desire to reduce the costs of owning and operating critical applications software, while shifting the risks and burdens associated with operating and maintaining the software to the software vendor, enabling the customer to focus its resources on its core business.

Rapidly evolving and increasingly complex customer requirements. The market for e-commerce solutions is constantly and rapidly evolving, as we and our competitors introduce new and enhanced products, retire older ones, and react to changes in Internet-related technology and customer demands, coalescence of product differentiators, product commoditization and evolving industry standards. To succeed, we need to enhance our current products and develop new products on a timely basis to keep pace with market needs, satisfy the increasingly sophisticated requirements of customers and leverage strategic alliances with third parties in the e-commerce field who have complementary products.

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

Competitive trend. The market for online sales, marketing and customer service software is intensely competitive, subject to rapid technological change, and significantly affected by new product introductions and other market activities. We expect competition to persist and intensify in the future. See Item 1, Business, for a more detailed discussion of our competition.

Recent Events

On February 5, 2008, we acquired CleverSet for approximately $10 million in cash, before adjustments. CleverSet is a provider of automated personalization engines used to optimize e-commerce experiences by presenting visitors with relevant recommendations and information. CleverSet s next-generation technology has been shown to significantly lift e-commerce revenue by increasing conversion rates and order size. We will offer these services under our eStara brand. We are currently determining the allocation of the purchase price based on the estimated fair values of assets and liabilities as of the acquisition date. We expect CleverSet to be dilutive to our earnings in 2008.

Critical Accounting Policies and Estimates

This Management s Discussion and Analysis of financial condition and results of operations discusses our consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principles.

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition, the allowance for accounts receivable, research and development costs, the impairment of long-lived assets and goodwill, income taxes and assumptions for stock-based compensation. Management bases its estimates and judgments on historical experience, known trends or events and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Definitions

We define our critical accounting policies as those that require us to make subjective estimates about matters that are uncertain and are likely to have a material impact on our financial condition and results of operations or that concern the specific manner in which we apply GAAP. Our estimates are based upon assumptions and judgments about matters that are highly uncertain at the time the accounting estimate is made and applied and require us to assess a range of potential outcomes.

We believe the following critical accounting policies to be both those most important to the portrayal of our financial condition and those that require the most subjective judgment.

Revenue Recognition

We generate revenue through the sale of product software licenses and related support and maintenance services, eStara e-commerce optimization services solutions, application hosting services and professional services. Please refer to the footnotes to the consolidated financial statements contained in Item 8 of this Annual Report on Form 10-K for a more comprehensive discussion of our revenue recognition policy. Our policy is to recognize revenue when the applicable revenue recognition criteria have been met, which generally include the following:

Persuasive evidence of an arrangement We use a legally binding contract signed by the customer as evidence of an arrangement. We consider the signed contract to be the most persuasive evidence of the arrangement.

Delivery has occurred or services rendered Software and the corresponding access keys are generally delivered to customers electronically. Electronic delivery occurs when we provide the customer access to the software. Our software license agreements generally do not contain conditions for acceptance. Our eStara e-commerce optimization services solutions and application hosting services are delivered on a monthly basis. Professional services are generally delivered on a time and material basis.

Price is fixed or determinable We assess whether a price is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. We have established a history of collecting under the original contract without providing concessions on payments, products or services. Our standard payment terms are primarily net 30 days.

Significant judgment is involved in assessing whether a fee is fixed or determinable. We must also make judgments when assessing whether a contract amendment constitutes a concession. Our experience has been that we are able to determine whether a fee is fixed or determinable. While we do not expect that experience to change, if we no longer were to have a history of collecting under the original contract terms without providing concessions on licenses, revenue from licenses would be required to be recognized when cash is received. Such a change could have a material impact on our results of operations.

Collection is probable We assess the probability of collecting from each customer at the outset of the arrangement based on a number of factors, including the customer s payment history and its current creditworthiness. If in our judgment collection of a fee is not probable, we do not record revenue until the uncertainty is removed, which generally means revenue is recognized upon our receipt of the cash payment. Our experience has been that we are generally able to estimate whether collection is probable. While we do not expect that experience to change, if we were to determine that collection is not probable for any arrangement, revenue from the elements of an arrangement would be recognized upon the receipt of cash payment unless other revenue recognition criteria are not met. Such a change could have a material impact on our results of operations.

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Generally we enter into arrangements that include multiple elements. Such arrangements may include sales of software licenses and related support and maintenance services in conjunction with application hosting services, eStara e-commerce optimization services solutions or professional services. In these situations we must determine whether the various elements meet the criteria to be accounted for as separate elements. If the elements cannot be separated, revenue is recognized once the revenue recognition criteria for the entire arrangement have been met or over the period that our obligations to the customer are fulfilled, as appropriate. If the elements are determined to be separable, revenue is allocated to the separate elements based on vendor specific objective evidence (VSOE) of fair value and recognized separately for each element when the applicable revenue recognition criteria for each element have been met. In accounting for these multiple element arrangements, we must make determinations about whether elements can be accounted for separately and make estimates regarding their relative fair values.

Recording revenue from arrangements that include application hosting services require us to estimate the estimated life of the customer arrangement. Pursuant to the application of relevant GAAP literature, EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, or EITF 00-21, our arrangements with application hosting services are accounted for as one unit of accounting. In such situations, we recognize the entire arrangement fee ratably over the term of the estimated life of the customer arrangement. Based on our historical experience with our customers, we estimate the life of the typical customer arrangement to be approximately four years.

Our VSOE of fair value for certain product elements of an arrangement is based upon the pricing in comparable transactions when the element is sold separately. VSOE of fair value for support and maintenance is generally based upon our history of charging our customers stated annual renewal rates. VSOE of fair value for professional services is generally based on the price charged when the services are sold separately. Annually, we evaluate whether or not we have maintained VSOE of fair value for support and maintenance services and professional services. We have concluded that we have maintained VSOE of fair value for both support and maintenance services and professional services because the majority of our support and maintenance contract renewal rates and professional service rates per personnel level fall in a narrow range of variability within each service offering.

For multiple element arrangements, VSOE of fair value must exist to allocate the total arrangement fee among all delivered and undelivered elements of a perpetual license arrangement. If VSOE of fair value does not exist for all elements to support the allocation of the total fee among all delivered and undelivered elements of the arrangement, revenue is deferred until such evidence does exist for the undelivered elements, or until all elements are delivered, whichever is earlier. If VSOE of fair value of all undelivered elements exists but VSOE of fair value does not exist for one or more delivered elements, revenue is recognized using the residual method. Under the residual method, the VSOE of fair value of the undelivered elements is deferred, and the remaining portion of the arrangement fee is recognized as revenue as the elements are delivered.

In certain instances, we sell perpetual software licenses with application hosting services and eStara e-commerce optimization services solutions. We do not have VSOE of fair value for any of these elements. In these situations all elements in the arrangement for which we receive up-front fees, which typically includes perpetual software fees, support and maintenance fees and set-up and implementation fees, are recognized as revenue ratably over the period of providing the application hosting service or eStara e-commerce optimization services solutions. We allocate and classify revenue in our statement of operations based on our evaluation of VSOE of fair value, or a proxy of fair value thereof, available for each applicable element of the transaction. We generally base our proxy of fair value on arms-length negotiations for the contracted elements. This allocation methodology requires judgment and is based on our analysis of our sales transactions.

Allowances for Accounts Receivable

We maintain allowances for estimated losses resulting from the inability of our customers to make required payments. We monitor collections and payments from our customers and determine the allowance based upon historical experience and specific customer collection issues. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required. Generally, we record allowances to revenue based on past credit memo history in the professional services business.

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Research and Development Costs

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

Costs incurred to develop software applications used in our eStara e-commerce optimization services solutions are accounted for in accordance with AICPA Statement of Position 98-1, *Accounting for Computer Software Developed or Obtained for Internal Use* (SOP 98-1). Capitalizable costs consist of (a) certain external direct costs of materials and services incurred in developing or obtaining internal-use computer software and (b) payroll and payroll-related costs for employees who are directly associated with, and who devote time to, the project. These costs generally consist of internal labor during configuration, coding and testing activities. Research and development costs incurred during the preliminary project stage or costs incurred for data conversion activities, training, maintenance and general and administrative or overhead costs are expenses as incurred. Costs that cannot be separated between maintenance of, and relatively minor upgrades and enhancements to, internal-use software are also expensed as incurred. Capitalization begins when the preliminary project stage is complete, management with the relevant authority authorizes and commits to the funding of the software project, it is probable the project will be completed, the software will be used to perform the functions intended and certain functional and quality standards have been met.

Our research and development efforts during 2007 related to our eStara e-commerce optimization services were primarily maintenance and data conversion costs. We did not capitalize any research and development costs during 2007.

Impairment or Disposal of Long Lived Assets, including Intangible Assets

We review our long-lived assets, including intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such assets are considered impaired, the impairment to be recognized is equal to the amount by which the carrying value of the assets exceeds their fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. In assessing recoverability, we must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related assumptions change in the future, we may be required to record impairment charges. Intangible assets with determinable lives are amortized over their estimated useful lives, based upon the pattern in which the expected benefits will be realized, or on a straight-line basis, whichever is greater.

Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired in a business combination. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we evaluate goodwill for impairment annually, as well as whenever events or changes in circumstances suggest that the carrying amount may not be recoverable. Because we have one reporting segment under SFAS 142, we utilize the entity-wide approach for assessing goodwill for impairment and compare our market value to our net book value to determine if impairment exists. No impairment of goodwill resulted from our evaluation of goodwill in any of the fiscal years presented, however these impairment tests may result in impairment losses that could have a material adverse impact on our results of operations.

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Accounting for Income Taxes

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. We evaluate the realizability of our deferred tax assets quarterly and adjust the amount of such allowance, if necessary. At December 31, 2007 and 2006, we have provided a full valuation allowance against our net deferred tax assets due to the uncertainty surrounding the realizability of these assets.

On January 1, 2007 we adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48, which did not result in a material adjustment in the liability for unrecognized income tax contingencies. The total net liability for uncertain tax positions was $0.5 million as of December 31, 2007. If these tax positions were settled in our favor these liabilities would be reversed and lower our effective tax rate in the period recorded.

Stock-Based Compensation Expense

Since January 1, 2006, we have accounted for stock-based compensation in accordance with SFAS No. 123(R). Under the fair value recognition provisions of SFAS No. 123(R), stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. We use the Black-Scholes option pricing model to determine the fair value of our stock option awards. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected life of the stock awards and the volatility of our underlying common stock. Changes to the assumptions may have a significant impact on the fair value of stock options, which could have a material impact on our financial statements. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. Should our actual forfeiture rates differ significantly from our estimates, our stock-based compensation expense and results of operations could be materially impacted.

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Results of Operations

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

	Year Ended December 31,		
	2007	2006	2005
Revenue:			
Product licenses	22%	32%	33%
Recurring services	56%	50%	49%
Professional and education services	22%	18%	18%
Total revenue	100%	100%	100%
Cost of Revenue:			
Product licenses	2%	2%	2%
Recurring services	18%	11%	7%
Professional and education services	21%	19%	19%
Total cost of revenue	41%	32%	28%
Gross Profit	59%	68%	72%
Operating Expenses:			
Research and development	18%	21%	20%
Sales and marketing	33%	30%	33%
General and administrative	13%	12%	12%
Restructuring charge (benefit)	0%	0%	1%
Total operating expenses	64%	63%	66%
Income (loss) from operations	(5)%	5%	6%
Interest and other income, net	2%	2%	0%
Income (loss) before provision (benefit) for income taxes	(3)%	7%	6%
Provision (benefit) for income taxes	0%	(2)%	0%
Net income (loss)	(3)%	9%	6%

The following table sets forth gross margin on product license revenue, recurring services revenue and professional and education services revenue for the periods indicated:

	Year Ended December 31,		
	2007	2006	2005
Cost of product license revenue	7%	5%	6%
Gross margin on product license revenue	93%	95%	94%
Cost of recurring services revenue	31%	22%	15%

Gross margin on recurring services revenue	69%	78%	85%
Cost of professional and education services revenue	98%	101%	101%
Gross margin on professional and education services revenue	2%	(1)%	(1)%

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Years ended December 31, 2007, 2006 and 2005

Revenues

	Years Ended December 31, 2007	2006	2005
	(In thousands)		
Total revenue	$ 137,060	$ 103,232	$ 90,646

Total revenue increased $33.8 million, or 33%, to $137.1 million for 2007 from $103.2 million for 2006, as a result of the acquisition of eStara in October 2006 which contributed revenue of $26.0 million in 2007 and to growth in professional and educational services revenue of $10.5 million. Partially offsetting the increase was a decrease in product license revenue of $2.3 million that was directly a result of the change in our business model requiring us to defer all revenue recognition for fees received up front when software licenses are sold in conjunction with managed application hosting services and or eStara e-commerce optimization services.

Total revenue increased 14% to $103.2 million for 2006 from $90.6 million for 2005, due to increases in product license revenue of $3.0 million, managed application hosting revenue of $1.8 million and professional service revenue of $2.6 million. Additionally, the fourth quarter of 2006 included $4.7 million of revenue attributable to the eStara acquisition.

Revenue generated from international customers increased to $43.4 million, or 32% of total revenue compared to 25% and 24% of revenue in the years ended December 31, 2006 and 2005, respectively.

No single customer accounted for 10% or more of total revenue for the years ended December 31, 2007, 2006 or 2005.

We expect full year 2008 revenues in the range of $159 million to $165 million.

Product License Revenue

	Years Ended December 31, 2007	2006	2005
Product license revenue	$ 30,529	$ 32,784	$ 29,821
As a percent of total revenue	22%	32%	33%

Product license revenue decreased 7%, to $30.5 million, for 2007 from $32.8 million in 2006. Product license revenue increased 10% to $32.8 million for 2006 from $29.8 million for 2005. The decrease for 2007 is due to deferrals of license revenue related to multiple element transactions in which we are hosting the software or providing e-commerce optimization service solutions. This license revenue will be recognized ratably over the term or life of the arrangement. Partially offsetting this impact is the recognition of $1.3 million in product license revenue which was deferred in prior periods. Product license revenue generated from international customers increased 37% to $12.3 million for 2007 from $9.0 million in 2006.

Product license revenue increased 10% to $32.8 million for 2006 from $29.8 million for 2005. The increase for 2006 is due to increased demand for our e-commerce product suite due to an improvement in the overall e-commerce market. Product license revenue generated from international customers increased 22% to $9.0 million in 2006 from $7.4 million for 2005 due to the development of several new international customers.

Product license revenue as a percentage of our total revenue declined to 22% in 2007 from 32% in 2006 and 33% in 2005. This change in revenue mix is due in part to the introduction in late 2006 of new services, such as our eStara e-commerce optimization services, that are recognized ratably and included in our recurring services revenue. The change in revenue mix is also a result of the change in our business model described above, that has resulted in an increased percentage of our software license revenue being recognized ratably. We expect that this percentage will increase over time as deferred product license revenue is recognized in future periods.

We expect that this transition in our revenue mix to continue in the near term. Although the diversity of our customers preferences regarding delivery models and business terms and the broad range of our products and services makes it challenging to predict the rate of this transition from quarter to quarter, we expect the percent of our product license revenue that is recognized ratably to increase throughout 2008 to approximately 50% on average for the year. We expect full year 2008 product license revenues to increase approximately 18-28% from 2007.

Product license bookings

Product License Bookings is a non-GAAP term that we define as product license revenue as reported in our statement of operations plus the net change in deferred product license revenue during the period. We believe that this measure provides us with a comparable result of the amount of new business that our direct sales team has added in the period. The following table summarizes our product license bookings for the years ended December 31, 2007, 2006 and 2005:

	Years Ended December 31,		
	2007	2006	2005
	(In thousands)		
Product license revenue	$ 30,529	$ 32,784	$ 29,821
Increase in product license deferred revenue	14,166	505	
Product license deferred revenue recognized	(1,283)	(477)	
Product license bookings	$ 43,412	$ 32,812	$ 29,821

We expect full year 2008 product license bookings to increase approximately 10-20% from 2007.

Recurring services revenue

	Years Ended December 31,		
	2007	2006	2005
Support and maintenance	$ 41,923	$ 39,303	$ 38,942
eStara e-commerce optimization services	25,980	4,690	
On demand	8,769	7,120	5,316
Total recurring services revenue	$ 76,672	$ 51,113	$ 44,258
As a percent of total revenue	56%	50%	49%

Our recurring services revenue increased 50% to $76.7 million in 2007 from $51.1 million in 2006, as follows:

Support and maintenance revenue increased 7% to $41.9 million in 2007 from $39.3 million in 2006. The increase is due to growth in our installed base of ATG e-commerce software attributable to the increase in product license bookings partially offset by approximately $1.1 million of revenue that was deferred due to arrangements that were sold in conjunction with application hosting services or eStara e-commerce optimization services.

eStara e-commerce optimization services revenue increased to $26.0 million in 2007 from $4.7 million in 2006. Revenues in 2007 included the full year s results of eStara, which we acquired in October 2006, and represented 34% of total recurring service revenue for 2007 compared with 9% in 2006.

On demand revenue, which represents revenue from arrangements in which we sold our ATG e-commerce software as a service on a hosted basis, increased 23% to $8.8 million for 2007 from $7.1 million for 2006.

Our recurring services revenue increased 16% to $51.1 million in 2006 from $44.3 million in 2005, as follows:

Support and maintenance revenue increased 1%, to $39.3 million, in 2006 from $38.9 million in 2005. The increase is due to growth in our installed base of ATG e-commerce software.

eStara e-commerce optimization services revenue increased to $4.7 million in 2006 from a base of zero in 2006 as a result of our acquisition of eStara in October 2006, and represented 9% of total recurring revenue in 2006.

On demand revenue increased 42% to $7.1 million in 2006 from $5.3 million in 2005 due to an increase of customers using our managed application hosting services.

Recurring services revenue as a percent of total revenue increased to 56% in 2007, from 50% in 2006 and 49% in 2005, consistent with the change in our business model described above. We expect our recurring services revenue as a percentage of total revenue to increase in the future. We expect full year 2008 recurring services revenue to increase approximately 23-24% from 2007, which includes approximately 10% growth in support and maintenance and approximately 35-45% growth in eStara and ATG On Demand.

Professional and educational services revenue

	Years Ended December 31,		
	2007	**2006**	**2005**
Professional services	$ 27,236	$ 17,634	$ 15,046
Education	2,623	1,701	1,521
Total professional & education services revenue	$ 29,859	$ 19,335	$ 16,567
As a percent of total revenue	22%	18%	18%

Professional and education services revenue increased 54% to $29.9 million in 2007 from $19.3 million in 2006, and increased as a percentage of total revenue to 22% in 2007 from 18% in 2006, as follows:

Professional services revenue consists primarily of revenue from consulting and implementation services, which typically are performed in the quarters closely following the execution of a product license transaction. Professional services revenue increased 55% to $27.2 million in 2007 from $17.6 million in 2006, due to an increase in implementation activity associated with growth in our product license bookings in 2007, partially offset by the deferral of revenue for services related to managed application hosting and e-commerce optimization arrangements that will be recognized ratably once the services commence.

Education revenue, which consists primarily of training of customer personnel, consultants and strategic partners on the use of our products and services, increased 54% to $2.6 million in 2007 from $1.7 million in 2006. The increase is a result of an increased focus on developing our partner and consultant practices.

Professional and educational services revenue increased 17% to $19.3 million in 2006 from $16.6 million in 2005, and represented 18% of total revenue in both 2006 and 2005. The increase in professional services revenue was driven by the following:

Professional services revenues increased 17% to $17.6 million in 2006 from $15.0 million in 2005. The increase was a result of growth and product license bookings during 2006.

Education revenue increased 12% to $1.7 million in 2006 from $1.5 million in 2005.

International professional and educational service revenue increased to $7.8 million in 2007 from $3.8 million in 2006 and $3.3 million in 2005. Based on our strategy to expand our partner ecosystem in order to leverage our partners global reach and resources, we are increasingly focusing on testing and certifying partners rather than continuing to grow our professional services business. For this reason, we expect minimal growth in professional services revenue for the full year of 2008.

Cost of Product License Revenues

	Years Ended December 31,		
	2007	**2006**	**2005**
Cost of product license revenue	$ 2,197	$ 1,751	$ 1,816
As a percent of license revenue	7%	5%	6%
Gross margin on product license revenue	$ 28,332	$ 31,033	$ 28,005
As a percent of license revenue	93%	95%	94%

Cost of product license revenue includes salary, benefits and stock-based compensation costs of fulfillment and engineering staff dedicated to maintenance of products that are in general release, the amortization of licenses

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purchased in support of and used in our products, royalties paid to vendors whose technology is incorporated into our products and amortization expense related to acquired developed technology.

Cost of product license revenue increased 26% to $2.2 million in 2007 from $1.8 million for 2006. Gross margin on product license revenue was 93%, or $28.3 million, in 2007 compared to 95%, or $31.0 million, in 2006. The increase in the cost of product license revenue and decrease in gross margin for 2007 was driven by an increase in royalty costs due to the mix of products sold and the decrease in product license revenue due to increased deferrals of product license revenue that will be recognized ratably in future periods.

Cost of product license revenue was $1.8 million in 2006 and 2005. Gross margin on product license revenue was 95%, or $31.0 million, in 2006 compared to 94%, or $28.0 million in 2005. The increase in product license gross margin for 2006 is attributable to higher product license revenue, partially offset by an increase in royalties.

We expect full year 2008 gross margin on product license revenue to approximately be 90% to 93% of product license revenue.

Cost of Recurring Services Revenue

	Years Ended December 31,		
	2007	**2006**	**2005**
Cost of recurring services revenue	$ 24,119	$ 11,239	$ 6,575
As a percent of recurring services revenue	31%	22%	15%
Gross margin on recurring services revenue	$ 52,553	$ 39,874	$ 37,683
As a percent of recurring services revenue	69%	78%	85%

Cost of recurring services revenues includes salary, benefits, and stock-based compensation and other costs for recurring services support staff, costs associated with the hosting centers, third-party contractors, amortization of technology acquired in connection with the eStara acquisition and royalties paid to vendors whose technology is incorporated into the software we use to provide recurring service products. When we perform professional consulting and implementation services in connection with on demand application hosting arrangements, we generally defer the cost of our implementation and set-up activities and amortize these to cost of revenue ratably over the estimated life of the arrangement once the hosting services commence. We deferred an aggregate of $3.1 million of set-up and implementation costs in 2007.

Cost of recurring services revenue increased 114% to $24.1 million in 2007 from $11.2 million in 2006. Gross margin on recurring services revenue was 69%, or $52.6 million, in 2007 compared to 78%, or $39.9 million, in 2006. The increase in cost of recurring services and the resulting decline in gross margin on recurring services in 2007 was due to direct costs associated with eStara e-commerce optimization services for a full year and to the amortization of intangible assets associated with the acquisition of eStara in the fourth quarter of 2006.

Cost of recurring services revenue increased 71% to $11.2 million in 2006 from $6.6 million in 2005. Gross margin on recurring services revenue was 78%, or $39.9 million, in 2006 and 85%, or $37.7 million, in 2005.

We expect full year 2008 gross margin on recurring services revenue to be 66% to 68% of recurring services revenue.

Cost of Professional and Education Services Revenues

	Years Ended December 31,		
	2007	2006	2005
Cost of professional and education services revenue	$ 29,223	$ 19,560	$ 16,680
As a percent of professional and education services revenue	98%	101%	101%
Gross margin on professional and education services revenue	$ 636	$ (225)	$ (113)
As a percent of professional and education services revenue	2%	(1)%	(1)%

Cost of professional and education services revenues includes salary, benefits, and stock-based compensation and other costs for professional services and technical support staff and third-party contractors.

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Cost of professional and education services revenue increased 49% to $29.2 million in 2007 from $19.6 million in 2006. Gross margin on professional and education services revenue was 2%, or $0.7 million in 2007 compared to (1)%, or $(0.2) million in 2006. The increase in cost of professional and education services in 2007 was driven by an increase in labor related costs for professional services due to growth in our professional services organization in respect to increased demand for implementation services resulting from higher product license bookings in 2007 compared to 2006.

Cost of professional and education services revenue increased 17% to $19.6 million in 2006 from $16.7 million in 2005. Gross margin on professional and education services revenue was (1)%, or $(0.2) million, in 2006 compared to (1)%, or $(0.1) million, in 2005. The increased cost of professional and education services revenue in 2006 was due to higher professional services salaries and salary related expenses of $1.3 million due to growth in our headcount, including stock-based compensation expense of $0.3 million related to our adoption of SFAS 123R in 2006.

We expect full year 2008 gross margin on professional and eduction services revenue to approximate 5-10% of professional and education services revenue.

Research and Development Expenses

	Years Ended December 31,		
	2007	**2006**	**2005**
Research & development expenses	$ 24,963	$ 21,517	$ 18,481
As a percent of total revenue	18%	21%	20%

Research and development expenses consist primarily of salary, benefits, and stock-based compensation costs to support product development. To date, all of our software development costs have been expensed as research and development in the period incurred.

Research and development expenses increased 16% to $25.0 million in 2007 from $21.5 million in 2006 and decreased as a percentage of revenue to 18% from 21%. The increase in research and development spending was due to a full year of expenses related to eStara which was acquired in the fourth quarter of 2006.

Research and development expenses increased 16% to $21.5 million in 2006 from $18.5 million in 2005 and increased as a percentage of revenue to 21% from 20%. The increase was due to an increase in outsourcing services of $1.6 million, eStara research and development costs of $0.3 million and stock-based compensation expense of $0.9 million related to our adoption of SFAS 123R in 2006.

We expect full year 2008 research and development expense will be approximately 19% of total revenue.

Sales and Marketing Expenses

	Years Ended December 31,		
	2007	**2006**	**2005**
Sales and marketing expenses	$ 44,397	$ 30,909	$ 29,396
As a percent of total revenue	33%	30%	33%

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

Sales and marketing expenses increased 44% to $44.4 million in 2007 from $30.9 million in 2006, and increased as a percentage of total revenue to 33% from 30%. The increase was due to an increase in cost of $8.9 million related to the eStara acquisition, a $2.4 million increase in commission expense related to higher product license bookings and increased spending on marketing programs.

We generally recognize commission expense upon contract execution. This policy has the effect of increasing sales and marketing expense as a percentage of total revenue when revenue is deferred and recognized ratably. As a result, another consequence of our change in business model is that in the near term our sales and marketing expenses are likely to grow at a rate that exceeds the rate of growth in our product license revenue.

Sales and marketing expenses increased 5% to $30.9 million in 2006 from $29.4 million in 2005, and decreased as a percentage of total revenue to 30% from 33%. The increase in sales and marketing expense was due to the inclusion of eStara expenses of $2.0 million, including amortization of acquired intangibles for customer relationships and stock-based compensation expense related to the adoption of SFAS 123R in 2006. The decrease as a percentage of total revenue was due to faster growth in revenue than in sales and marketing expenses driven by a $1.9 million decline in outside marketing services.

We expect that full year 2008 sales and marketing expense will be approximately 33% of total revenue.

General and Administrative Expenses

	Years Ended December 31,		
	2007	**2006**	**2005**
General and administrative expenses	$ 18,211	$ 12,952	$ 11,231
As a percent of total revenue	13%	12%	12%

General and administrative expenses consist primarily of salaries, benefits, and stock-based compensation and other related costs for internal systems, finance, human resources, legal and executive related functions.

General and administrative expenses increased 41% to $18.2 million in 2007 from $13.0 million in 2006, and increased as a percentage of total revenue to 13% from 12%.

General and administrative expenses increased 15% to $13.0 million in 2006 from $11.2 million in 2005, and represented 12% of total revenue in 2006 compared to 12% in 2005.

The increases in 2007 of $5.2 million was attributable to the inclusion of a full year s results for eStara in 2007. eStara contributed $3.3 million of general and administrative expenses to 2007 compared to $0.7 million in 2006. Salaries and other related costs, including stock-based compensation, in general and administrative expenses increased $2.3 million in 2007, which includes $1.8 million related to eStara. In 2007 we incurred $1.4 million in general and administrative expenses related to remedial actions taken to correct two material weaknesses in our internal control over financial reporting identified at December 31, 2006, including outside service fees and other one-time costs. This increase in general and administrative expenses included $0.3 million for one-time projects that we do not expect to recur in 2008.

The increase in 2006 of $1.7 million was attributable to the acquisition of eStara in the fourth quarter of 2006. eStara contributed $0.7 million of general and administrative expenses to 2006. In addition, the increase in 2006 is also due to stock-based compensation expense of $1.1 million in 2006 related to our adoption of SFAS 123R in 2006.

For 2007, 2006 and 2005, general and administrative expenses as a percentage of total revenue were 13%, 12% and 12%, respectively. The increase is primarily attributable to an increase in external professional services.

We expect that full year 2008 general and administrative expenses will be approximately 11% of total revenue.

Stock-Based Compensation Expense

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment,* or SFAS 123R, using the modified prospective transition method. Compensation cost is calculated on the date of grant using the fair value of the options as calculated by the Black-Scholes option pricing model and is recognized ratably over the employee s service period.

The adoption of SFAS 123R on January 1, 2006 had the following impact on the years ended December 31:

2007 operating loss before taxes and net loss were higher by $4.2 million and basic and diluted loss per share were higher by $0.03, respectively;

2006 operating profit before taxes and net income were lower by $3.6 million and basic and diluted earnings per share were lower by $0.04 and $0.03, respectively;

than if we had continued to account for share based compensation under APB 25. In 2007, we issued 2.4 million shares of restricted stock and restricted stock units to our employees and board members. We expect to use restricted stock and restricted stock units regularly in the future. Stock compensation expense related to restricted stock and restricted stock unit awards made to employees and non-employee directors was $1.6 million, $0.2 million and $0.0 million for the years ended December 31, 2007, 2006 and 2005, respectively.

As of December 31, 2007, the total compensation cost related to unvested awards not yet recognized in the statement of operations was approximately $12.9 million, which will be recognized over a weighted average period of approximately 2.0 years.

Restructuring

In 2005 and prior years, we implemented restructuring actions to realign our operating expenses and facilities with the requirements of our business and current market conditions and recorded adjustments to prior restructuring charges. These actions have included closure and consolidation of excess facilities, reductions in the number of our employees, abandonment or disposal of tangible assets and settlement of contractual obligations. In connection with these actions we have recorded restructuring charges, based in part upon our estimates of the costs ultimately to be paid for the actions we took. When circumstances result in changes in our estimates relating to our accrued restructuring costs, we reflect these changes as additional charges or benefits in the period in which the change of estimate occurs. As of December 31, 2007, we had restructuring accruals of $1.1 million. We recorded net restructuring benefits of $0.1 million in each of 2007 and 2006 and net restructuring charges of $0.9 million in 2005. For detailed information about our restructuring activities and related costs and accruals, see Note 10 to the Consolidated Financial Statements contained in Item 8 of this Annual Report on Form 10-K.

Interest and Other Income, Net

Interest and other income, net increased to $2.2 million in 2007 from $1.7 million in 2006. The increase was primarily due to an increase in interest income resulting from our higher average cash and investment balances and foreign currency exchange gains due to continuing weakness in the U.S. dollar versus the U.K. Pound Sterling and the Euro. Cash, cash equivalents and marketable securities increased $20.9 million in 2007 to $51.9 million at December 31, 2007.

Interest and other income, net increased to $1.7 million in 2006 from $0.2 million in 2005. The increase is primarily due to foreign exchange gains in 2006 compared to losses in 2005, together with higher interest income in 2006 compared to 2005.

Provision (Benefit) for Income Taxes

For the year ended December 31, 2007, we recorded an income tax provision of $0.4 million. This relates to earnings in certain of our foreign subsidiaries as well as interest and penalties related to certain tax positions. In 2006, we recorded a tax benefit of $2.6 million related to reversing certain tax reserves in foreign locations that were no longer required due to closed tax years under audit and the expiration of the statute of limitations at certain foreign jurisdictions.

We recorded minimal Federal income taxes in 2007 and no Federal income taxes in 2006 and 2005 due to taxable operating losses and the use of net operating loss carryforwards. In addition, we had no foreign income taxes in 2006 due to taxable operating losses in certain foreign locations in 2006 and the use of net operating loss carryforwards.

As a result of historical net operating losses incurred and after evaluating our anticipated performance over our normal planning horizon, we have provided a full valuation allowance against our net operating loss carryforwards, research and development credit carryforwards and other net deferred tax assets. The primary differences between book and tax income for 2006 are the amortization of capitalized research and development expenses and payments on lease restructuring reserves, partially offset by SFAS 123R stock compensation expenses. We adopted

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FIN No. 48, *Accounting for Uncertainty in Income Taxes,* on January 1, 2007 without a material impact to the financial statements.

eStara Acquisition

In October 2006, we acquired all of the outstanding shares of common stock of eStara, Inc. (eStara). The aggregate purchase price was approximately $49.8 million, which consisted of $39.2 million of our common stock, $2.2 million of transaction costs, which primarily consisted of fees paid for financial advisory, legal and accounting services and a transaction bonus to eStara employees of $4.8 million, and $3.6 million in cash paid lieu of issuing ATG common stock to non accredited investors. We issued approximately 14.6 million shares of our common stock, the fair value of which was based upon a five-day average of the closing price two days before and two days after the terms of the acquisition were agreed to and publicly announced. In addition, we issued 0.3 million shares of restricted stock, which is being recognized as stock-based compensation expense over the vesting term. In the preliminary allocation of the purchase price the excess of the purchase price over the net assets acquired resulted in goodwill of $32.1 million.

As required by the merger agreement, in 2007 we recorded contingent consideration of $2.0 million for earn-out payments to eStara stockholders and employees as a result of eStara generating revenue in excess of $25 million but less than $30 million in 2007. The earn-out payments were made in cash in March 2008 and consisted of $0.6 million for stockholders and $1.4 million for employees. The payments to stockholders were recorded as additional purchase price, and the amounts paid to employees were accounted for as compensation expense as it relates to amounts paid to eStara employee stockholders in excess of that paid to non-employee stockholders.

Liquidity and Capital Resources

Our capital requirements relate primarily to facilities, employee infrastructure and working capital requirements. Our primary sources of liquidity at December 31, 2007 were our cash, cash equivalents, and short and long-term marketable securities of $51.9 million.

Cash provided by operating activities was $26.3 million in 2007.

Although we incurred a net loss of $4.2 million, it included non-cash expenses for depreciation and amortization of $7.9 million, and stock-based compensation expense of $5.8 million.

Deferred revenue increased $22.1 million during the year. Most of the invoices related to this deferred revenue were collected in 2007 and therefore increased our cash flow from operations. Under applicable revenue recognition rules, a portion of this amount was not recognized as revenue in 2007 as discussed earlier, thereby lowering our net income.

Accounts receivable increased $5.6 million, or 17.0% in 2007. The increase in accounts receivable is due to a 33%, or $33.8 million, increase in revenue and a $12.9 million increase in product license deferred revenue partially offset by collections of outstanding accounts receivable balances.

Accrued expenses increased $4.1 million in 2007 due to higher operating expenses in 2007. We will be required to pay cash in future periods for these expenses that were recorded in 2007.

We deferred $3.1 million of costs related to the implementation of customer websites during 2007. Deferring these costs has the effect of a cash outflow in 2007 that will be recorded as expense in future periods.

Net cash used in investing activities in 2007 was $9.9 million, which consisted of $4.8 million of capital expenditures, primarily computer equipment and software for the on demand business, $4.2 million in net purchases of marketable securities, and $0.8 million in payments for the eStara acquisition.

Net cash used in financing activities was minimal in 2007. Financing activities consisted primarily of $2.9 million in proceeds from exercised stock options and the employee stock purchase plan, offset by $2.9 million in repurchases of our common stock. On April 19, 2007 our Board of Directors authorized a stock repurchase program providing for repurchases of our outstanding common stock of up to $20 million, in the open market or in privately negotiated transactions, at times and prices considered appropriate depending on prevailing market conditions. During the year ended December 31, 2007, we repurchased 986,960 of shares of our common stock at a cost of $2.9 million. We have authorization to expend an additional $17.1 million under this program as of December 31, 2007.

We believe that our balance of $51.9 million in cash, cash equivalents and marketable securities at December 31, 2007, along with other working capital and cash expected to be generated by our operations, will allow us to meet our liquidity requirements over at least the next twelve months and for the foreseeable future. However, our actual cash requirements will depend on many factors, including particularly, overall economic conditions both domestically and abroad. We may find it necessary or advisable to seek additional external funds through public or private securities offerings, strategic alliances or other financing sources. There can be no assurance that if we seek external funding, it will be available on favorable terms, if at all.

We have made the following disbursements in 2008 related to current and prior business acquisitions: we paid approximately $9 million in February 2008 in connection with the CleverSet acquisition and we paid $2 million in March 2008 in contingent consideration related to the eStara acquisition.

Accounts Receivable and Days Sales Outstanding

Our accounts receivable balance and days sales outstanding and modified days sales outstanding for the fourth quarter ended December 31, 2007 and 2006 were as follows:

	Quarter Ended December 31,	
	2007	2006
	(Dollar amounts in thousands)	
Days sales outstanding	93	97
Revenue	$ 39,326	$ 32,207
Accounts receivable, net	$ 40,443	$ 34,554
Modified days sales outstanding	82	89
Percent of accounts receivable less than 60 days	88%	86%

We evaluate our performance on collections on a quarterly basis. As of December 31, 2007, our days sales outstanding decreased from December 31, 2006 due to collections on support and maintenance renewals as well as the effect of receiving payments on sales that were made during the current and previous quarter.

Credit Facility

At December 31, 2007, we maintained a $20.0 million revolving line of credit with Silicon Valley Bank (the Bank), pursuant to an Amended and Restated Loan and Security Agreement (the Loan Agreement) dated as of June 13, 2002, which provides for borrowings of up to the lesser of $20.0 million or 80% of eligible accounts receivable. The line of credit bears interest at the Bank s prime rate (7.25% at December 31, 2007). The line of credit is secured by all of our tangible and intangible intellectual and personal property and is subject to financial covenants including profitability and liquidity coverage. As of December 31, 2007, we were in compliance with all covenants in the Loan Agreement, as amended.

While there were no outstanding borrowings under the facility at December 31, 2007, the bank had previously issued letters of credit totaling $2.6 million on our behalf, which were supported by this facility. The letters of credit were issued in favor of various landlords to secure obligations under facility leases pursuant to leases expiring through December 2011. As a result, at December 31, 2007, approximately $17.4 million was available under the facility.

On January 31, 2008, we allowed the credit facility to expire and accordingly, we cash collateralized the $2.6 million in letters of credit with certificates of deposit, which will be reflected on subsequent balance sheets as restricted cash.

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Contractual Obligations

On December 31, 2007, our contractual cash obligations, which consist of operating leases and tax obligations, were as follows (in thousands):

Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Leases	$ 12,427	$ 4,668	$ 4,811	$ 2,119	$ 829
Tax obligations	1,968	1,481			487
	$ 14,395	$ 6,149	$ 4,811	$ 2,119	$ 1,316

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (Statement 157). Statement 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. Statement 157 also expands financial statement disclosures about fair value measurements. On February 6, 2008, the FASB issued FASB Staff Position (FSP) 157-b, which delays the effective date of Statement 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Statement 157 and FSP 157-b are effective for financial statements issued for fiscal years beginning after November 15, 2007. We have elected a partial deferral of Statement 157 under the provisions of FSP 157-b related to the measurement of fair value used when evaluating goodwill, intangible assets and long-lived assets for impairment and valuing liabilities for exit or disposal activities. The impact of partially adopting Statement 157 effective January 1, 2008 is not expected to be material to our consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115* (Statement 159), which permits but does not require us to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has not been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. As we have not elected to fair value any of our financial instruments under the provisions of Statement 159, the adoption of this statement will not have any impact to our consolidated financial statements.

In December 2007, the FASB issued Statement No. 141(R), *Business Combinations,* (Statement 141(R)), a replacement of FASB Statement No. 141. Statement 141(R) is effective for fiscal years beginning on or after December 15, 2008 and applies to all business combinations. Statement 141(R) provides that, upon initially obtaining control, an acquirer shall recognize 100 percent of the fair values of acquired assets, including goodwill, and assumed liabilities, with only limited exceptions, even if the acquirer has not acquired 100 percent of its target. As a consequence, the current step acquisition model will be eliminated. Additionally, Statement 141(R) changes current practice, in part, as follows: (1) contingent consideration arrangements will be fair valued at the acquisition date and included on that basis in the purchase price consideration; (2) transaction costs will be expensed as incurred, rather than capitalized as part of the purchase price; (3) pre-acquisition contingencies, such as legal issues, will generally have to be accounted for in purchase accounting at fair value; (4) in order to accrue for a restructuring plan in purchase accounting, the requirements in FASB Statement No. 146, *Accounting for Costs Associated with Exit or*

Disposal Activities, would have to be met at the acquisition date; and (5) In-process research and development charges will no longer be recorded. While there is no expected impact to our consolidated financial statements on the accounting for acquisitions completed prior to December 31, 2008, the adoption of Statement 141(R) on January 1, 2009 could materially change the accounting for business combinations consummated subsequent to that date.

In December 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 110 (SAB 110). SAB 110 amends and replaces Question 6 of Section D.2 of Topic 14, *Share-Based Payment*. SAB 110 expresses the views of the staff regarding the use of the simplified method in developing an estimate of expected term of plain vanilla share options in accordance with FASB Statement No. 123(R), *Share Based Payment.* The

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use of the simplified method was scheduled to expire on December 31, 2007. SAB 110 extends the use of the simplified method for plain vanilla awards in certain situations. We currently use the simplified method to estimate the expected term for share option grants and we will continue to use the simplified method until we have sufficient data to provide a reasonable estimate of expected term in accordance with SAB 110.

Item 7A. *Quantitative and Qualitative Disclosures about Market Risk*

We maintain an investment portfolio consisting mainly of investment grade money market funds, corporate obligations and government obligations with a weighted average maturity of less than one year. These held-to-maturity securities are subject to interest rate risk. However, a 10% change in interest rates would not have a material impact to the fair values of these securities at December 31, 2007 and 2006 primarily due to their short maturity and our intent to hold the securities to maturity. There have been no significant changes since December 31, 2007.

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 foreign currencies. Our primary foreign currency exposures relate to our short-term intercompany balances with our foreign subsidiaries and accounts receivable valued in the United Kingdom in U.S. dollars. Our primary foreign subsidiaries have functional currencies denominated in the British pound and Euro, and foreign denominated assets and liabilities are remeasured each reporting period with any exchange gains and losses recorded in our consolidated statements of operations. Based on currency exposures existing at December 31, 2007 and 2006, a 10% movement in foreign exchange rates would not expose us to significant gains or losses in earnings or cash flows. We may use derivative instruments to manage the risk of exchange rate fluctuations. However, at December 31, 2007, we had no outstanding derivative instruments. We do not use derivative instruments for trading or speculative purposes.

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Item 8. *Consolidated Financial Statements and Supplementary Data*

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Art Technology Group, Inc.

We have audited the accompanying consolidated balance sheets of Art Technology Group, Inc. as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2007. 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 the standards of the Public Company Accounting Oversight Board (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 accounting 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Art Technology Group, Inc. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1(m) to the financial statements, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, using the modified-prospective transition method. Additionally, as discussed in Note 1(l) to the financial statement, effective January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Art Technology Group, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 11, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts
March 11, 2008

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ART TECHNOLOGY GROUP, INC.

CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2007	December 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 34,419	$ 17,911
Marketable securities	16,460	13,312
Accounts receivable, net of reserves of $958 ($447 in 2006)	40,443	34,554
Deferred costs, current	790	
Prepaid expenses and other current assets	2,741	2,501
Total current assets	94,853	68,278
Property and equipment, net	7,208	5,326
Deferred costs, less current portion	2,337	
Marketable securities	1,062	
Other assets	1,475	1,036
Intangible assets, net	11,109	16,013
Goodwill	59,675	59,328
	$ 177,719	$ 149,981
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 3,619	$ 2,607
Accrued expenses	19,082	15,791
Deferred revenue, current portion	35,577	23,708
Accrued restructuring, current portion	855	1,213
Capital lease obligations		56
Total current liabilities	59,133	43,375
Accrued restructuring, less current portion	225	1,031
Deferred revenue, less current portion	10,777	501
Other liabilities	487	
Commitments and contingencies (Note 7 and 11)		
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 200,000,000 shares; issued and outstanding 129,293,221 shares and 127,055,373 shares at December 31, 2007 and 2006, respectively	1,293	1,270
Additional paid-in capital	305,151	296,291
Accumulated deficit	(195,745)	(191,558)

Treasury stock, at cost (986,960 shares at December 31, 2007)	(2,902)	
Accumulated other comprehensive loss	(700)	(929)
Total stockholders equity	107,097	105,074
	$ 177,719	$ 149,981