

ART TECHNOLOGY GROUP INC

Form 10-Q

August 09, 2004

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2004**

**OR**

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

**For the Transition Period from to**

**Commission file number 000-26679**

**ART TECHNOLOGY GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**04-3141918**

(I.R.S. Employer Identification Number)

**25 First Street, Cambridge, Massachusetts**

(Address of principal executive offices)

**02141**

(Zip Code)

**(617) 386-1000**

(Registrant's telephone number, including area code)

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

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

As of August 6, 2004 there were 73,887,620 shares of the Registrant's common stock outstanding.



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

	<b>June 30, 2004</b>	<b>December 31, 2003</b>
	<hr/>	<hr/>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 22,533	\$ 31,934
Marketable securities	2,832	9,650
Accounts receivable, net of reserves of \$770 (\$799 in 2003)	10,897	15,364
Prepaid expenses and other current assets	2,633	1,949
	<hr/>	<hr/>
Total current assets	38,895	58,897
Property and equipment, net	3,013	3,751
Long term marketable securities	7,390	
Other assets	4,304	4,712
	<hr/>	<hr/>
	\$ 53,602	\$ 67,360
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 1,933	\$ 1,146
Accrued expenses	10,383	12,363
Deferred revenue	14,196	14,915
Accrued restructuring, short-term	4,149	9,427
	<hr/>	<hr/>
Total current liabilities	30,661	37,851
Accrued restructuring, less current portion	7,150	8,572
Commitments and contingencies (Notes 8 and 9)		
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 73,828,622 shares and 72,936,165 shares at June 30, 2004 and December 31, 2003,	738	729

respectively		
Additional paid-in capital	219,765	218,927
Deferred compensation		(11)
Accumulated deficit	(201,725)	(195,691)
Accumulated other comprehensive loss	(2,987)	(3,017)
	<u>          </u>	<u>          </u>
 Total Stockholders' Equity	 15,791	 20,937
	<u>          </u>	<u>          </u>
	\$ 53,602	\$ 67,360
	<u>          </u>	<u>          </u>

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

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Revenues:				
Product license	\$ 3,144	\$ 9,464	\$ 9,508	\$ 16,970
Services	11,188	11,842	21,634	23,761
Total Revenues	14,332	21,306	31,142	40,731
Cost of Revenues:				
Product license	331	647	730	1,131
Services	5,125	5,104	9,910	10,844
Total Cost of Revenues	5,456	5,751	10,640	11,975
Gross Profit	8,876	15,555	20,502	28,756
Operating Expenses:				
Research and development	4,150	4,967	8,280	9,841
Sales and marketing	7,231	8,096	14,572	16,882
General and administrative	1,739	2,374	3,669	5,030
Restructuring benefit		(5,442)		(5,442)
Total Operating Expenses	13,120	9,995	26,521	26,311
Income (Loss) from Operations	(4,244)	5,560	(6,019)	2,445
Interest and Other Income, Net	64	490	17	851
Income (loss) before provision for income taxes	(4,180)	6,050	(6,002)	3,296
Provision for Income Taxes	67		32	
Net income (loss)	\$ (4,247)	\$ 6,050	\$ (6,034)	\$ 3,296
Basic net income (loss) per share	\$ (0.06)	\$ 0.08	\$ (0.08)	\$ 0.05

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Diluted net income (loss) per share	<u>\$ (0.06)</u>	<u>\$ 0.08</u>	<u>\$ (0.08)</u>	<u>\$ 0.05</u>
Basic weighted average common shares outstanding	<u>73,193</u>	<u>71,475</u>	<u>73,289</u>	<u>71,228</u>
Diluted weighted average common shares outstanding	<u>73,193</u>	<u>73,141</u>	<u>73,289</u>	<u>72,324</u>

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

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

	<b>Six Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>
<b>Cash Flows from Operating Activities:</b>		
Net income (loss)	\$ (6,034)	\$ 3,296
Adjustments to reconcile net income (loss) to net cash used in operating activities		
Stock-based compensation	11	99
Depreciation and amortization	1,039	2,373
Non-cash restructuring charge		847
Loss on disposal of fixed assets, net	100	60
Changes in current assets and liabilities		
Accounts receivable, net	4,467	8,651
Prepaid expenses and other current assets	(684)	50
Other assets	404	(1,365)
Accounts payable	787	(419)
Accrued expenses	(1,980)	(3,004)
Deferred revenues	(719)	(83)
Accrued restructuring	(6,700)	(21,146)
	<u>(9,309)</u>	<u>(10,641)</u>
<b>Cash Flows from Investing Activities:</b>		
Maturities of marketable securities	8,743	17,778
Purchases of marketable securities	(9,313)	(9,049)
Purchases of property and equipment	(345)	(775)
Proceeds from sale of equipment		45
Decrease in other assets	4	153
	<u>(911)</u>	<u>8,152</u>
<b>Cash Flows from Financing Activities:</b>		
Proceeds from exercise of stock options	332	70
Proceeds from employee stock purchase plan	515	543
	<u>847</u>	<u>613</u>

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Effect of Foreign Exchange Rate Changes on Cash and Cash Equivalents	(28)	(857)
Net Decrease in Cash and Cash Equivalents	(9,401)	(2,733)
Cash and Cash Equivalents, Beginning of Period	<u>31,934</u>	<u>45,829</u>
Cash and Cash Equivalents, End of Period	<u>\$22,533</u>	<u>\$ 43,096</u>

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

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

**(1) OPERATIONS AND BASIS OF PRESENTATION**

Art Technology Group, Inc. (ATG or the Company) offers an integrated suite of Internet online marketing, sales and service applications, as well as related application development, integration and support services.

ATG delivers software solutions to help consumer-facing organizations create an interactive experience for their customers and partners via the Internet and other channels. The Company's software helps its clients market, sell and provide self-service opportunities to their customers and partners, which can enhance clients' revenues, reduce their costs and improve their customers' satisfaction. The Company also offers related services, including support, education and professional services.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q. The disclosures do not include all of the information and footnotes required by accounting principles generally accepted in the United States, and while the Company believes that the disclosures presented are adequate to make information not misleading, these financial statements should be read in conjunction with the audited financial statements and related notes included in the Company's 2003 Annual Report on Form 10-K. In the opinion of management, the accompanying unaudited condensed consolidated financial statements and notes contain all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. The operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results to be expected for the full year ending December 31, 2004.

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

Certain amounts reported in previous periods have been reclassified to conform to the current period presentation. Such reclassifications were not material.

**(2) STOCKHOLDERS' EQUITY**

*Stock-Based Compensation*

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

Had compensation expense for ATG's Stock Plans been recorded consistent with the fair value method under FAS 123, the pro forma net loss and net loss per share would have been as follows (in thousands, except per share amounts):

**Three months ended June  
30,**

**Six months ended June 30,**

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	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Net income (loss) as reported	\$(4,247)	\$ 6,050	\$ (6,034)	\$ 3,296
Add: Stock-based compensation expense included in reported income (loss)		18	11	99
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	<u>(4,522)</u>	<u>(10,909)</u>	<u>(10,958)</u>	<u>(25,016)</u>
Pro forma net loss	<u>\$(8,769)</u>	<u>\$ (4,841)</u>	<u>\$(16,981)</u>	<u>\$(21,621)</u>
Basic and diluted net income (loss) per share				
As reported	\$ (0.06)	\$ 0.08	\$ (0.08)	\$ 0.05
Pro forma	\$ (0.12)	\$ (0.07)	\$ (0.23)	\$ (0.30)

*Amendments to the Amended and Restated 1996 Stock Option Plan and the 1999 Outside Director Stock Option Plan*

During the three months ended June 30, 2004, shareholders approved resolutions to further amend the Amended and Restated 1996 Stock Option Plan to allow for the grant of restricted stock awards, performance share awards and other forms of equity based compensation that were not previously provided for in the plan and extend the term of the plan until December 31, 2013. Additionally, shareholders approved resolutions to further amend the Amended and Restated 1999 Outside Director Stock Option Plan (the Director Plan) to allow for the grant of restricted stock and extend the term of the Director Plan until December 31, 2013. Pursuant to the amendments to the Director Plan, \$2,500 of each outside director's annual retainer will be paid in the form of restricted stock.

**Table of Contents****(3) NET INCOME (LOSS) PER SHARE**

Net income (loss) per share is computed under SFAS No. 128, *Earnings Per Share*. Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding, plus the dilutive effect of common stock equivalents, which consist of stock options, using the treasury stock method.

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per-share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Net income (loss)	\$ (4,247)	\$ 6,050	\$ (6,034)	\$ 3,296
Weighted average common shares outstanding	73,194	71,475	73,289	71,228
Weighted average common stock equivalents outstanding:				
Employee stock options		1,666		1,096
Total weighted average common stock and common stock equivalents	73,193	73,141	73,289	72,324
Basic net income (loss) per share	\$ (0.06)	\$ 0.08	\$ (0.08)	\$ 0.05
Diluted net income (loss) per share	\$ (0.06)	\$ 0.08	\$ (0.08)	\$ 0.05

**(4) REVENUE RECOGNITION**

ATG recognizes product license revenues from licensing the rights to use its software to end-users. ATG also generates service revenues from integrating its software with its customers' operating environments, the sale of maintenance services and the sale of certain other consulting and development services. ATG generally has separate agreements with its customers that govern the terms and conditions of its software licenses, consulting and support and maintenance services. These separate agreements, along with ATG's price list and business practices of selling services separately, provide the basis for establishing vendor-specific objective evidence of fair value. This allows ATG to appropriately allocate fair value among the multiple elements in an arrangement and apply the residual method under Statement of Position (SOP) No. 97-2, *Software Revenue Recognition* (SOP 97-2) and SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions* (SOP 98-9).

ATG recognizes revenue in accordance with SOP 97-2 and SOP 98-9. Revenues from software product license agreements are recognized upon execution of a license agreement and delivery of the software, provided that the fee is fixed or determinable and deemed collectible by management. If conditions for acceptance are required subsequent to delivery, revenues are recognized upon customer acceptance if such acceptance is not deemed to be perfunctory. In multiple element arrangements, ATG uses the residual value method in accordance with SOP 97-2 and SOP 98-9. Revenue earned on software arrangements involving multiple elements that qualify for separate element accounting treatment is allocated to each undelivered element using the relative fair values of those elements based on vendor-specific objective evidence with the remaining value assigned to the delivered element, the software license. Typically, the Company's software licenses do not include significant post-delivery obligations to be fulfilled by the Company and payments are due within a three-month period from the date of delivery. Consequently, product license revenue is generally recognized when the product is shipped. Revenues from software maintenance agreements are recognized ratably over the term of the maintenance period, which is typically one year. ATG enters into reseller arrangements that typically provide for sublicense fees payable to ATG based upon a percentage of ATG's list price. Revenues are recognized under reseller agreements as earned for guaranteed minimum royalties, or based upon actual sales by the resellers. ATG does not grant its resellers the right of return or price protection.

Revenues from professional service arrangements are recognized on either a time-and-materials, proportional performance method or percentage-of-completion basis as the services are performed, provided that amounts due from customers are fixed or determinable and deemed collectible by management. From time to time the Company enters into fixed price service arrangements. In those circumstances in which services are essential to the functionality of the software, the Company applies the percentage-of-completion method, and in those situations when only professional services are provided, the Company applies the proportional performance method. Both of these methods require that the Company track the effort expended and the effort expected to complete a project. Amounts collected or billed prior to satisfying the above revenue recognition criteria are reflected as deferred revenue. Deferred revenue primarily consists of advance payments related to support and maintenance and service agreements.

#### **(5) CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES**

ATG accounts for investments in marketable securities under FAS 115, *Accounting for Certain Investments in Debt and Equity*

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*Securities* (FAS 115). Under FAS 115, investments for which ATG has the positive intent and the ability to hold to maturity, consisting of cash equivalents and marketable securities, are reported at amortized cost, which approximates fair market value. Cash equivalents are highly liquid investments with maturities at the date of acquisition of less than 90 days. Marketable securities are investment grade debt securities with maturities at the date of acquisition of greater than ninety days. At June 30, 2004 and December 31, 2003, all of ATG's marketable securities were classified as held-to-maturity. The average maturity of ATG's marketable securities was approximately 9.2 months and 3.5 months at June 30, 2004 and December 31, 2003, respectively. At June 30, 2004 the average maturity of the marketable securities classified as long-term was 17.5 months. At June 30, 2004 and December 31, 2003, the difference between the amortized cost and market value of ATG's marketable securities were gains (losses) of approximately (\$87,000) and \$4,000, respectively. At June 30, 2004 and December 31, 2003, ATG's cash, cash equivalents and marketable securities consisted of the following (in thousands):

	<b>June 30, 2004</b>	<b>December 31, 2003</b>
	<u>                    </u>	<u>                    </u>
Cash and cash equivalents		
Cash	\$ 7,395	\$11,767
Money market accounts	12,716	20,167
U.S. Government Agency Commercial Paper	2,022 400	
	<u>                    </u>	<u>                    </u>
Total cash and cash equivalents	\$22,533	\$31,934
	<u>                    </u>	<u>                    </u>
Marketable securities		
Corporate securities	\$ 9,221	\$ 8,642
U.S. Government Agency	1,001	1,008
	<u>                    </u>	<u>                    </u>
Total marketable securities	\$10,222	\$ 9,650
	<u>                    </u>	<u>                    </u>

**(6) COMPREHENSIVE INCOME (LOSS)**

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

<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>

Net income (loss)	\$ (4,247)	\$ 6,050	\$ (6,034)	\$ 3,296
Foreign currency translation income (loss)	68	(522)	30	(802)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Comprehensive income (loss)	\$ (4,179)	\$ 5,528	\$ (6,004)	\$ 2,494
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

The accumulated other comprehensive loss at June 30, 2004 and December 31, 2003, of \$3.0 million consisted entirely of the cumulative foreign currency translation adjustment.

## **(7) DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE**

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

Revenues from sources outside of the United States were approximately \$4.3 million and \$9.9 million for the three months ended June 30, 2004 and 2003, respectively, and \$10.8 million and \$14.7 million for the six months ended June 30, 2004 and 2003,

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respectively. ATG's revenue from international sources was primarily generated from customers located in Europe and Asia/Pacific. All of ATG's software licenses for the three and six months ended June 30, 2004 and 2003 were delivered from its headquarters located in the United States.

The following table represents the percentage of total revenues by geographic region from customers for the three and six months ended June 30, 2004 and 2003:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
United States	70%	53%	65%	64%
United Kingdom (UK)	8	27	17	17
Europe, Middle East and Africa (excluding UK)	20	17	13	15
Other	2	3	5	4
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

**(8) LONG-TERM OBLIGATIONS***Credit Facility*

Effective June 13, 2002, ATG entered into a \$15 million revolving line of credit with Silicon Valley Bank (the Bank) which provided for borrowings of up to the lesser of \$15 million or 80% of eligible accounts receivable. Effective December 24, 2002 the revolving line of credit increased to \$20 million.

Effective November 25, 2003, ATG modified its existing revolving line of credit with the Bank. This \$20 million line of credit is secured by all of ATG's tangible and intangible intellectual and personal property and is subject to financial covenants including liquidity coverage and profitability. The liquidity covenant mandates ATG maintain \$25.0 million in cash, which includes cash equivalents and marketable securities, at the end of each month throughout the duration of the facility. The profitability covenant, which was modified in June 2004 pursuant to the Fifth Loan Modification Agreement, allows for net losses not to exceed: \$5.0 million for the second quarter of 2004, \$2.0 million for the third quarter of 2004 and \$1.0 million for the fourth quarter of 2004. ATG is required to maintain \$25 million in unrestricted cash, which includes cash equivalents and marketable securities, at the Bank. In the event ATG's cash balances at the Bank fall below \$25 million, ATG will be required to pay fees and expenses to compensate the Bank for lost income. At June 30, 2004, ATG was in compliance with all amended related financial covenants. In the event that ATG does not comply with any of the financial covenants within the line of credit or defaults on any of its provisions, the Bank's significant remedies include: (1) declaring all obligations immediately due and payable; (2) ceasing to advance money or extend credit for the Company's benefit; (3) applying to the obligations any balances and deposits held by the Company or any amount held by the Bank owing to or for the credit or the account of ATG; and, (4) putting a hold on any deposit account held as collateral. If the agreement expires, or is not extended, the Bank will require outstanding Letters of Credit (LC's) at that time to be cash secured on terms acceptable to the Bank. The revolving line of credit expires on November 25, 2004.

While there were no outstanding borrowings under the facility at June 30, 2004, ATG has issued LC's totaling \$10.6 million, which are supported by this facility. The LC's have been issued in favor of various landlords and equipment vendors to secure lease obligations pursuant to leases expiring from August 2004 through August 2009. The line of credit bears interest at the Bank's prime rate (4.25% at June 30, 2004). As of June 30, 2004, approximately \$9.4 million was available under the facility.

## **(9) COMMITMENTS AND CONTINGENCIES**

### *Leases*

ATG has offices, primarily for sales and support personnel, in 8 domestic locations as well as four foreign countries. At June 30, 2004, ATG has issued \$10.6 million of LC's under its line of credit in favor of various landlords and equipment vendors to secure lease obligations, which expire from 2004 through 2009.

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The approximate future minimum payments of ATG's facility leases and certain operating equipment leases as of June 30, 2004, are as follows (in thousands):

	<b>Operating Leases</b>
	<hr/>
Remainder of 2004	\$ 3,317
2005	6,693
2006	5,106
2007	2,299
2008	1,846
Thereafter	461
	<hr/>
Total future minimum lease payments	\$19,722
	<hr/>

The \$19.7 million in future minimum lease payments includes \$12.6 million of obligations on facilities that are included in the Company's restructuring accrual. The \$12.6 million was reduced to an \$11.0 million restructuring accrual after taking into consideration contracted and estimated sublease income, vacancy periods and operating costs of the various subleased properties (Note 10).

Rent expense included in the accompanying statements of operations was \$1.2 million and \$1.4 million for the three months ended June 30, 2004 and 2003, respectively, and \$2.4 million and \$2.9 million for the six months ended June 30, 2004 and 2003, respectively. Rent expense does not include \$1.5 million and \$2.7 million for the three months ended June 30, 2004 and 2003 and \$2.5 million and \$4.6 million for the six months ended June 30, 2004 and 2003, respectively, in rent charged to the restructuring accrual.

*Indemnifications*

The Company frequently has agreed to indemnification provisions in software license agreements with customers and in its real estate leases in the ordinary course of its business.

With respect to software license agreements, these indemnifications generally include provisions indemnifying the customer against losses, expenses, and liabilities from damages that may be awarded against the customer in the event the Company's software is found to infringe upon the intellectual property of others. The software license agreements generally limit the scope of and remedies for such indemnification obligations in a variety of industry-standard respects. The Company believes its internal development processes and other policies and practices limit its exposure related to the indemnification provisions of the software license agreements. In addition, the Company requires its employees to sign a proprietary information and inventions agreement, which assigns the rights to its employees development work to the Company. To date, the Company has not had to reimburse any of its customers for any losses related to these indemnification provisions and no material claims are outstanding as of June 30, 2004.

With respect to real estate lease agreements or settlement agreements with landlords, these indemnifications typically apply to claims asserted against the landlord relating to personal injury and property damage at the leased premises or to certain breaches of the Company's contractual obligations or representations and warranties included in the settlement agreements. These indemnification provisions generally survive the termination of the respective

agreements, although the provision generally has the most relevance during the contract term and for a short period of time thereafter. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is unlimited. The Company has purchased insurance that reduces its monetary exposure for landlord indemnifications. The Company has never paid any amounts to defend lawsuits or settle claims related to these indemnification provisions. Accordingly, the Company believes the estimated fair value of these indemnification arrangements is minimal.

## **(10) RESTRUCTURING**

During the years ended 2003, 2002 and 2001, the Company recorded net restructuring charges/(benefits) of (\$10.5) million, \$19.0 million and \$75.6 million, respectively, as a result of the global slowdown in information technology spending. The significant drop in demand in 2001 for technology oriented products, particularly internet related technologies, caused management to significantly scale back the Company's prior growth plans, resulting in a significant reduction in the Company's workforce and consolidation of the Company's facilities in 2001. Throughout 2002, the continued softness of demand for technology products, as well as near term revenue projections, caused management to further evaluate the Company's marketing, sales and service resource capabilities as well as its overall general and administrative cost structure, which resulted in additional restructuring actions being taken in 2002. These actions resulted in a further reduction in headcount and consolidation of additional facilities. In 2003, as the Company continued to refine its business strategy and to consider future revenue opportunities, the Company took further restructuring actions to reduce costs, including product development costs, in order to help move the Company towards profitability. The charges referred to above primarily pertain to the closure and consolidation of excess facilities, impairment of assets, employee severance benefits, and the settlement of certain contractual obligations. The 2003 charges were recorded in accordance with FAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, FAS 88, *Employers' Accounting for Settlements and*

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*Curtailments of Defined Benefit Pension Plans and for Termination Benefits (FAS 88) and Staff Accounting Bulletin (SAB) 100, Restructuring and Impairment Charges.* The 2002 and 2001 charges were recorded in accordance with Emerging Issues Task Force Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)*, FAS 88 and SAB 100.

**2001 Actions**

Actions taken by the Company in 2001 included the consolidation and closure of excess facilities, a worldwide workforce reduction, the write-off of certain unrealizable assets and settling certain obligations that had no future benefit. In the second quarter of 2001, the Company recorded a restructuring charge of \$44.2 million, and in the fourth quarter of 2001, the Company recorded a restructuring charge of \$31.4 million. In connection with these actions, the Company also recorded an impairment charge in cost of product licenses for purchased software of \$1.4 million. Total restructuring charges for 2001 totaled \$75.6 million.

A summary of the restructuring accrual activity in 2004 is as follows (in thousands):

	<b>Accrued Restructuring Balance as of December 31, 2003</b>	<b>Payments</b>	<b>Accrued Restructuring Balance as of June 30, 2004</b>
	<u>          </u>	<u>          </u>	<u>          </u>
Facilities-related costs and impairments	\$ 10,208	\$ 2,178	\$ 8,030
Employee severance, benefits and related costs	229		229
	<u>          </u>	<u>          </u>	<u>          </u>
Total	<u>\$ 10,437</u>	<u>\$ 2,178</u>	<u>\$ 8,259</u>

***Facilities-Related Costs and Impairments***

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