

LIVEPERSON INC  
Form 10-Q  
August 08, 2011  
UNITED STATES

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, 2011

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: 000-30141

LIVEPERSON, INC.  
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
(State or Other Jurisdiction of  
Incorporation or Organization)

13-3861628  
(IRS Employer Identification No.)

475 TENTH AVENUE, 5th FLOOR  
NEW YORK, NEW YORK  
(Address of Principal Executive Offices)

10018  
(Zip Code)

(212) 609-4200  
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of August 1, 2011, there were 53,038,813 shares of the issuer's common stock outstanding.

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LIVEPERSON, INC.  
JUNE 30, 2011  
FORM 10-Q

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FORWARD-LOOKING STATEMENTS

STATEMENTS IN THIS REPORT ABOUT LIVEPERSON, INC. THAT ARE NOT HISTORICAL FACTS ARE FORWARD-LOOKING STATEMENTS BASED ON OUR CURRENT EXPECTATIONS, ASSUMPTIONS, ESTIMATES AND PROJECTIONS ABOUT LIVEPERSON AND OUR INDUSTRY. THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL FUTURE EVENTS OR RESULTS TO DIFFER MATERIALLY FROM SUCH STATEMENTS. ANY SUCH FORWARD-LOOKING STATEMENTS ARE MADE PURSUANT TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. IT IS ROUTINE FOR OUR INTERNAL PROJECTIONS AND EXPECTATIONS TO CHANGE AS THE YEAR OR EACH QUARTER IN THE YEAR PROGRESS, AND THEREFORE IT SHOULD BE CLEARLY UNDERSTOOD THAT THE INTERNAL PROJECTIONS AND BELIEFS UPON WHICH WE BASE OUR EXPECTATIONS MAY CHANGE PRIOR TO THE END OF EACH QUARTER OR THE YEAR. ALTHOUGH THESE EXPECTATIONS MAY CHANGE, WE ARE UNDER NO OBLIGATION TO INFORM YOU IF THEY DO. OUR COMPANY POLICY IS GENERALLY TO PROVIDE OUR EXPECTATIONS ONLY ONCE PER QUARTER, AND NOT TO UPDATE THAT INFORMATION UNTIL THE NEXT QUARTER. ACTUAL EVENTS OR RESULTS MAY DIFFER MATERIALLY FROM THOSE CONTAINED IN THE PROJECTIONS OR FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE THOSE DISCUSSED IN PART II, ITEM 1A, "RISK FACTORS."

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## LIVEPERSON, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

|  | June 30,<br>2011<br>(Unaudited) | December 31,<br>2010<br>(Note1(B)) |
|--|---------------------------------|------------------------------------|
| <b>ASSETS</b>  |                                 |                                    |
| Current assets:  |                                 |                                    |
| Cash and cash equivalents  | \$ 74,378                       | \$ 61,336                          |
| Accounts receivable, net of allowance for doubtful accounts of \$681 and \$561 as of June 30, 2011 and December 31, 2010, respectively   | 17,747                          | 16,491                             |
| Prepaid expenses and other current assets  | 5,123                           | 6,341                              |
| Deferred tax assets, net   | 1,202                           | 1,529                              |
| Total current assets   | 98,450                          | 85,697                             |
| Property and equipment, net  | 13,456                          | 12,762                             |
| Intangibles, net   | 1,489                           | 2,124                              |
| Goodwill   | 24,090                          | 24,015                             |
| Deferred tax assets, net   | 4,018                           | 3,876                              |
| Deferred implementation costs, net of current  | 213                             | 164                                |
| Security deposits  | 462                             | 499                                |
| Other assets   | 1,819                           | 2,006                              |
| Total assets   | \$ 143,997                      | \$ 131,143                         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                 |                                    |
| Current liabilities:   |                                 |                                    |
| Accounts payable   | \$ 6,914                        | \$ 6,416                           |
| Accrued expenses   | 10,000                          | 12,111                             |
| Deferred revenue   | 5,555                           | 5,570                              |
| Total current liabilities  | 22,469                          | 24,097                             |
| Deferred revenue, net of current   | 828                             | 513                                |
| Other liabilities  | 1,819                           | 1,890                              |
| Total liabilities  | 25,116                          | 26,500                             |
| Commitments and contingencies  |                                 |                                    |
| Stockholders' equity:  |                                 |                                    |
| Preferred stock, \$.001 par value per share; 5,000,000 shares authorized, 0 shares issued and outstanding at June 30, 2011 and December 31, 2010   | —                               | —                                  |
| Common stock, \$.001 par value per share; 100,000,000 shares authorized, 52,890,715 shares issued and outstanding at June 30, 2011 and 51,753,842 shares issued and outstanding at December 31, 2010 | 53                              | 52                                 |
| Additional paid-in capital   | 213,900                         | 205,063                            |
| Accumulated deficit  | (94,745)                        | (100,173)                          |
| Accumulated other comprehensive loss   | (327)                           | (299)                              |

|  |            |            |
|--|------------|------------|
| Total stockholders' equity                 | 118,881    | 104,643    |
| Total liabilities and stockholders' equity | \$ 143,997 | \$ 131,143 |

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED  
CONSOLIDATED FINANCIAL STATEMENTS.

## LIVEPERSON, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)  
UNAUDITED

|   | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2011                           | 2010       | 2011                         | 2010       |
| Revenue   | \$ 31,851                      | \$ 26,398  | \$ 62,234                    | \$ 51,706  |
| Operating expenses:   |                                |            |                              |            |
| Cost of revenue   | 8,685                          | 7,178      | 16,780                       | 13,810     |
| Product development   | 5,016                          | 3,908      | 9,393                        | 7,514      |
| Sales and marketing   | 9,379                          | 8,452      | 18,239                       | 16,142     |
| General and administrative  | 5,386                          | 4,175      | 9,346                        | 7,967      |
| Amortization of intangibles   | 11                             | 83         | 22                           | 166        |
| Total operating expenses  | 28,477                         | 23,796     | 53,780                       | 45,599     |
| Income from operations  | 3,374                          | 2,602      | 8,454                        | 6,107      |
| Other income (expense):   |                                |            |                              |            |
| Financial income (expense)  | 208                            | (41)       | 363                          | (90)       |
| Interest income   | 16                             | 30         | 30                           | 53         |
| Total other income (expense), net   | 224                            | (11)       | 393                          | (37)       |
| Income before provision for income taxes  | 3,598                          | 2,591      | 8,847                        | 6,070      |
| Provision for income taxes  | 1,402                          | 975        | 3,419                        | 2,318      |
| Net income  | \$ 2,196                       | \$ 1,616   | \$ 5,428                     | \$ 3,752   |
| Basic net income per common share   | \$ 0.04                        | \$ 0.03    | \$ 0.10                      | \$ 0.07    |
| Diluted net income per common share   | \$ 0.04                        | \$ 0.03    | \$ 0.10                      | \$ 0.07    |
| Weighted average shares outstanding used in basic net income per common share calculation   | 52,735,556                     | 50,921,609 | 52,409,769                   | 50,383,042 |
| Weighted average shares outstanding used in diluted net income per common share calculation | 55,553,247                     | 53,416,706 | 55,125,730                   | 52,803,871 |

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED  
CONSOLIDATED FINANCIAL STATEMENTS.

## LIVEPERSON, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)  
UNAUDITED

|   | Six Months Ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2011                         | 2010      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                              |           |
| Net income  | \$ 5,428                     | \$ 3,752  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |           |
| Stock-based compensation expense  | 3,214                        | 2,173     |
| Depreciation  | 3,225                        | 2,335     |
| Amortization of intangibles   | 635                          | 778       |
| Deferred income taxes   | 185                          | (42)      |
| Provision for doubtful accounts   | 120                          | 15        |
| <b>CHANGES IN OPERATING ASSETS AND LIABILITIES:</b>                               |                              |           |
| Accounts receivable   | (1,376)                      | (2,379)   |
| Prepaid expenses and other current assets   | 1,244                        | (199)     |
| Deferred implementation costs   | (49)                         | (17)      |
| Security deposits   | 39                           | (150)     |
| Other Assets  | 116                          | —         |
| Accounts payable  | 852                          | (312)     |
| Accrued expenses  | (2,123)                      | (2,594)   |
| Deferred revenue  | 300                          | 201       |
| Net cash provided by operating activities   | 11,810                       | 3,561     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                              |           |
| Purchases of property and equipment, including capitalized software               | (4,297)                      | (2,339)   |
| Acquisition of NuConomy, net of cash acquired                                     | —                            | (789)     |
| Acquisition of Proficient   | (75)                         | —         |
| Net cash used in investing activities   | (4,372)                      | (3,128)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                              |           |
| Excess tax benefit from the exercise of employee stock options                    | 545                          | 34        |
| Proceeds from issuance of common stock in connection with the exercise of options | 5,078                        | 6,846     |
| Net cash provided by financing activities   | 5,623                        | 6,880     |
| Effect of foreign exchange rate changes on cash and cash equivalents              | (19)                         | (46)      |
| Net increase in cash and cash equivalents   | 13,042                       | 7,267     |
| Cash and cash equivalents at the beginning of the period                          | 61,336                       | 45,572    |
| Cash and cash equivalents at the end of the period                                | \$ 74,378                    | \$ 52,839 |

## Supplemental disclosure of non-cash investing activities:

Cash flows from investing activities for the six months ended June 30, 2011 and June 30, 2010 does not include the purchase of approximately \$877 and \$1,578, respectively of capitalized equipment related to the Company's



collocation facility because the corresponding invoices are included in accounts payable for the corresponding six month period, and therefore did not have an impact on cash flows.

During the six months ended June 30, 2011 and 2010, total net cash paid for income taxes was \$511 and \$1,444, respectively.

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED  
CONSOLIDATED FINANCIAL STATEMENTS.

LIVEPERSON, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

(1) SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

(A) SUMMARY OF OPERATIONS

LivePerson, Inc. (the “Company” or “LivePerson”) provides online engagement solutions that facilitate real-time assistance and expert advice. Connecting businesses and independent service providers with individual consumers seeking help on the Web, the Company’s hosted software platform creates more relevant, compelling and personalized online experiences. The Company was incorporated in 1995 and commenced operations in 1996.

The Company’s primary revenue source is from the sale of the LivePerson services to businesses of all sizes. The Company also facilitates online transactions between independent service providers (“Experts”) who provide online advice to individual consumers (“Users”). Headquartered in New York City, the Company’s product development staff, help desk and online sales support are located in Israel. The Company also maintains sales and professional services offices in Atlanta, San Francisco and the United Kingdom.

(B) UNAUDITED CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The accompanying condensed consolidated financial statements as of June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 are unaudited. In the opinion of management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the consolidated financial position of LivePerson as of June 30, 2011, and the consolidated results of operations and cash flows for the interim periods ended June 30, 2011 and 2010. The financial data and other information disclosed in these notes to the condensed consolidated financial statements related to these periods are unaudited. The results of operations for any interim period are not necessarily indicative of the results of operations for any other future interim period or for a full fiscal year. The condensed consolidated balance sheet at December 31, 2010 has been derived from audited consolidated financial statements at that date.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto for the year ended December 31, 2010, included in the Company’s Annual Report on Form 10-K filed with the SEC on March 15, 2011.

(C) REVENUE RECOGNITION

The majority of the Company’s revenue is generated from monthly service revenues and related professional services from the sale of the LivePerson services. Because the Company provides its application as a service, the Company follows the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 605-10-S99, “Revenue Recognition” and ASC 605-25, “Revenue Recognition with Multiple-Element Arrangements.” The Company charges a monthly fee, which varies by type of service, the level of client usage and website traffic, and in some cases, the number of orders placed via the Company’s online engagement solutions.

For certain of the Company's larger clients, the Company may provide call center labor through an arrangement with one or more of several qualified partners. For most of these clients, the Company passes the fee it incurs with the labor provider and its fee for the hosted services through to its customers in the form of a fixed fee for each order placed via the Company's online engagement solutions. For these arrangements, the Company recognizes revenue net of the labor provider's fee in accordance with ASC 605-45, "Principal Agent Considerations," due to the fact that the Company performs as an agent without risk of loss for collection.

The majority of the Company's larger clients also pay a professional services fee related to implementation. The Company defers these implementation fees and associated direct costs and recognizes them ratably over the expected term of the client relationship upon commencement of the hosting services. The Company may also charge professional service fees related to additional training, business consulting and analysis in support of the LivePerson services.

The Company also sells certain of the LivePerson services directly via Internet download. These services are marketed as LivePerson Pro and LivePerson Contact Center for small and mid-sized businesses (“SMBs”), and are paid for almost exclusively by credit card. Credit card payments accelerate cash flow and reduce the Company’s collection risk, subject to the merchant bank’s right to hold back cash pending settlement of the transactions. Sales of LivePerson Pro and LivePerson Contact Center may occur with or without the assistance of an online sales representative, rather than through face-to-face or telephone contact that is typically required for traditional direct sales.

The Company recognizes monthly service revenue based upon the fee charged for the LivePerson services, provided that there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable. The Company’s service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days’ notice without penalty. When professional service fees add value to the customer on a standalone basis, the Company recognizes professional service fees upon completion and customer acceptance in accordance with FASB Accounting Standards Update 2009-13. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. If a professional services arrangement does not qualify for separate accounting, the Company recognizes the fees, and the related labor costs, ratably over a period of 48 months, representing the Company’s current estimate of the term of the client relationship.

For revenue generated from online transactions between Experts and Users, the Company recognizes revenue net of the Expert fees in accordance with ASC 605-45, “Principal Agent Considerations,” due to the fact that the Company performs as an agent without any risk of loss for collection. The Company collects a fee from the User and retains a portion of the fee, and then remits the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable.

#### (D) STOCK-BASED COMPENSATION

The Company follows FASB ASC 718-10, “Stock Compensation,” which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. ASC 718-10 requires measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized.

The following table summarizes stock-based compensation expense related to employee stock options under ASC 718-10 included in Company’s Statements of Income for the three and six months ended June 30, 2011 and 2010:

|   | Three Months Ended |          | Six Months Ended |          |
|---|--------------------|----------|------------------|----------|
|   | June 30,           |          | June 30,         |          |
|   | 2011               | 2010     | 2011             | 2010     |
| Cost of revenue   | \$ 248             | \$ 196   | \$ 546           | \$ 410   |
| Product development expense                                   | 441                | 327      | 881              | 662      |
| Sales and marketing expense                                   | 443                | 277      | 779              | 557      |
| General and administrative expense                            | 547                | 286      | 1,008            | 544      |
| Total stock based compensation included in operating expenses | \$ 1,679           | \$ 1,086 | \$ 3,214         | \$ 2,173 |



The per share weighted average fair value of stock options granted during the three and six months ended June 30, 2011 was \$7.07 and \$6.97, respectively. The per share weighted average fair value of stock options granted during the three and six months ended June 30, 2010 was \$3.97 and \$3.81, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                          | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               |
|--------------------------|--------------------------------|---------------|------------------------------|---------------|
|                          | 2011                           | 2010          | 2011                         | 2010          |
| Dividend yield           | 0.0%                           | 0.0%          | 0.0%                         | 0.0%          |
| Risk-free interest rate  | 2.9% - 3.5%                    | 3.2% - 3.7%   | 2.9% - 3.7%                  | 3.2% - 3.8%   |
| Expected life (in years) | 5.0                            | 5.0           | 5.0                          | 5.0           |
| Historical volatility    | 60.7% - 61.5%                  | 60.4% - 61.6% | 60.7% - 61.5%                | 60.3% - 61.6% |

During 1998, the Company established the Stock Option and Restricted Stock Purchase Plan (the “1998 Plan”). Under the 1998 Plan, the Board of Directors could issue incentive stock options or nonqualified stock options to purchase up to 5,850,000 shares of common stock. The 2000 Stock Incentive Plan (the “2000 Plan”) succeeded the 1998 Plan. Under the 2000 Plan, the options which had been outstanding under the 1998 Plan were incorporated in the 2000 Plan increasing the number of shares available for issuance under the plan by approximately 4,150,000, thereby reserving for issuance 10,000,000 shares of common stock in the aggregate.

The Company established the 2009 Stock Incentive Plan (the “2009 Plan”) as a successor to the 2000 Plan. Under the 2009 Plan, the options which had been outstanding under the 2000 Plan were incorporated into the 2009 Plan and the Company increased the number of shares available for issuance under the plan by 6,000,000, thereby reserving for issuance 19,567,744 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have ten-year terms. As of June 30, 2011, approximately 13,967,000 shares of common stock were reserved for issuance under the 2009 Plan (taking into account all option exercises through June 30, 2011). As of June 30, 2011, there was approximately \$20,887 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost, as of June 30, 2011, is expected to be recognized over a weighted average period of approximately 2.2 years.

In March 2000, the Company adopted the 2000 Employee Stock Purchase Plan with 450,000 shares of common stock initially reserved for issuance (the “2000 ESPP”). The 2000 ESPP expired on its terms on the last day of April 2010.

In June 2010, our stockholders approved the 2010 Employee Stock Purchase Plan with 1,000,000 shares of common stock initially reserved for issuance. As of June 30, 2011, approximately 964,000 shares of common stock were reserved for issuance under the Employee Stock Purchase Plan (taking into account all share purchases through June 30, 2011).

A summary of the Company’s stock option activity and weighted average exercise prices follows:

|  | Options   | Weighted<br>Average<br>Exercise Price |
|--|-----------|---------------------------------------|
| Options outstanding at December 31, 2010 | 8,816,760 | \$ 5.04                               |
| Options granted                          | 1,608,300 | 12.75                                 |

|                                      |              |      |
|--------------------------------------|--------------|------|
| Options exercised                    | (1,098,526)  | 4.36 |
| Options cancelled                    | (563,130)    | 6.28 |
| Options outstanding at June 30, 2011 | 8,763,404    | 6.47 |
| Options exercisable at June 30, 2011 | 3,579,372 \$ | 4.36 |

The total value of stock options exercised during the six months ended June 30, 2011 was approximately \$7,345. The total intrinsic value of options exercisable at June 30, 2011 was approximately \$34,602. The total intrinsic value of nonvested options at June 30, 2011 is approximately \$32,286. The total intrinsic value of all outstanding options at June 30, 2011 is \$66,888.

A summary of the status of the Company's nonvested shares as of December 31, 2010, and changes during the six months ended June 30, 2011 is as follows:

|                                       | Shares      | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|---------------------------------------|-------------|--|
| Nonvested Shares at December 31, 2010 | 5,719,012   | \$ 3.13  |
| Granted                               | 1,608,300   | 6.97   |
| Vested                                | (1,580,150) | 2.94   |
| Cancelled                             | (563,130)   | 3.46   |
| Nonvested Shares at June 30, 2011     | 5,184,032   | \$ 4.36  |

#### (E) BASIC AND DILUTED NET INCOME PER SHARE

The Company calculates earnings per share ("EPS") in accordance with the provisions of ASC 260-10 and the guidance of SEC Staff Accounting Bulletin ("SAB") No. 98. Under ASC 260-10, basic EPS excludes dilution for common stock equivalents and is computed by dividing net income or loss attributable to common shareholders by the weighted average number of common shares outstanding for the period. All options, warrants or other potentially dilutive instruments issued for nominal consideration are required to be included in the calculation of basic and diluted net income attributable to common stockholders. Diluted EPS is calculated using the treasury stock method and reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and resulted in the issuance of common stock.

Diluted net income per common share for the three and six months ended June 30, 2011 includes the effect of options to purchase 6,963,746 and 6,744,246 shares, respectively, of common stock with a weighted average exercise price of \$4.90 and \$4.77, respectively. Diluted net income per common share for the three and six months ended June 30, 2010 includes the effect of options to purchase 6,471,753 and 6,271,753 shares, respectively, of common stock with a weighted average exercise price of \$3.51 and \$3.42, respectively.

A reconciliation of shares used in calculating basic and diluted earnings per share follows:

|                                     | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|-------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                     | 2011                           | 2010       | 2011                         | 2010       |
| Basic                               | 52,735,556                     | 50,921,609 | 52,409,769                   | 50,383,042 |
| Effect of assumed exercised options | 2,817,691                      | 2,495,097  | 2,715,961                    | 2,420,829  |
| Diluted                             | 55,553,247                     | 53,416,706 | 55,125,730                   | 52,803,871 |

#### (F) SEGMENT REPORTING

The Company accounts for its segment information in accordance with the provisions of ASC 280-10, "Segment Reporting." ASC 280-10 establishes annual and interim reporting standards for operating segments of a company. ASC 280-10 requires disclosures of selected segment-related financial information about products, major customers, and geographic areas based on the Company's internal accounting methods. The Company is organized into two operating segments for purposes of making operating decisions and assessing performance. The Business segment supports and manages real-time online interactions – chat, voice/click-to-call, email and self-service/knowledgebase and sells its products and services to global corporations of all sizes. The Consumer segment facilitates online transactions



between Experts and Users and sells its services to consumers. Both segments currently generate their revenue primarily in the U.S. The chief operating decision-makers evaluate performance, make operating decisions, and allocate resources based on the operating income of each segment. The reporting segments follow the same accounting polices used in the preparation of the Company's consolidated financial statements which are described in the summary of significant accounting policies. The Company allocates cost of revenue, sales and marketing and amortization of purchased intangibles to the segments, but it does not allocate product development expenses, general and administrative expenses and income tax expense because management does not use this information to measure performance of the operating segments. There are currently no inter-segment sales.

Summarized financial information by segment for the three months ended June 30, 2011, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | Consolidated  | Corporate   | Business      | Consumer     |
|--------------------------------|---------------|-------------|---------------|--------------|
| <b>Revenue:</b>                |               |             |               |              |
| Hosted services — Business     | \$ 26,736     | \$ —        | \$ 26,736     | \$ —         |
| Hosted services — Consumer     | 3,735         | —           | —             | 3,735        |
| Professional services          | 1,380         | —           | 1,380         | —            |
| <b>Total revenue</b>           | <b>31,851</b> | <b>—</b>    | <b>28,116</b> | <b>3,735</b> |
| Cost of revenue                | 8,685         | —           | 7,688         | 997          |
| Sales and marketing            | 9,379         | —           | 7,822         | 1,557        |
| Amortization of intangibles    | 11            | —           | 11            | —            |
| Unallocated corporate expenses | 10,402        | 10,402      | —             | —            |
| Operating income (loss)        | \$ 3,374      | \$ (10,402) | \$ 12,595     | \$ 1,181     |

Summarized financial information by segment for the three months ended June 30, 2010, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | Consolidated  | Corporate  | Business      | Consumer     |
|--------------------------------|---------------|------------|---------------|--------------|
| <b>Revenue:</b>                |               |            |               |              |
| Hosted services — Business     | \$ 21,823     | \$ —       | \$ 21,823     | \$ —         |
| Hosted services — Consumer     | 3,428         | —          | —             | 3,428        |
| Professional services          | 1,147         | —          | 1,147         | —            |
| <b>Total revenue</b>           | <b>26,398</b> | <b>—</b>   | <b>22,970</b> | <b>3,428</b> |
| Cost of revenue                | 7,178         | —          | 6,250         | 928          |
| Sales and marketing            | 8,452         | —          | 6,664         | 1,788        |
| Amortization of intangibles    | 83            | —          | 11            | 72           |
| Unallocated corporate expenses | 8,083         | 8,083      | —             | —            |
| Operating income (loss)        | \$ 2,602      | \$ (8,083) | \$ 10,045     | \$ 640       |

Revenues attributable to domestic and foreign operations for the three months ended June 30, 2011 and 2010, follows:

|                      | June 30,         |                  |
|----------------------|------------------|------------------|
|                      | 2011             | 2010             |
| United States        | \$ 24,311        | \$ 20,196        |
| United Kingdom       | 4,299            | 3,519            |
| Other countries      | 3,241            | 2,683            |
| <b>Total revenue</b> | <b>\$ 31,851</b> | <b>\$ 26,398</b> |

Summarized financial information by segment for the six months ended June 30, 2011, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | Consolidated  | Corporate   | Business      | Consumer     |
|--------------------------------|---------------|-------------|---------------|--------------|
| <b>Revenue:</b>                |               |             |               |              |
| Hosted services — Business     | \$ 52,321     | \$ —        | \$ 52,321     | \$ —         |
| Hosted services — Consumer     | 7,393         | —           | —             | 7,393        |
| Professional services          | 2,520         | —           | 2,520         | —            |
| <b>Total revenue</b>           | <b>62,234</b> | <b>—</b>    | <b>54,841</b> | <b>7,393</b> |
| Cost of revenue                | 16,780        | —           | 14,875        | 1,905        |
| Sales and marketing            | 18,239        | —           | 15,137        | 3,102        |
| Amortization of intangibles    | 22            | —           | 22            | —            |
| Unallocated corporate expenses | 18,739        | 18,739      | —             | —            |
| Operating income (loss)        | \$ 8,454      | \$ (18,739) | \$ 24,807     | \$ 2,386     |

Summarized financial information by segment for the six months ended June 30, 2010, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | Consolidated  | Corporate   | Business      | Consumer     |
|--------------------------------|---------------|-------------|---------------|--------------|
| <b>Revenue:</b>                |               |             |               |              |
| Hosted services — Business     | \$ 42,736     | \$ —        | \$ 42,736     | \$ —         |
| Hosted services — Consumer     | 6,886         | —           | —             | 6,886        |
| Professional services          | 2,084         | —           | 2,084         | —            |
| <b>Total revenue</b>           | <b>51,706</b> | <b>—</b>    | <b>44,820</b> | <b>6,886</b> |
| Cost of revenue                | 13,810        | —           | 11,934        | 1,876        |
| Sales and marketing            | 16,142        | —           | 12,692        | 3,450        |
| Amortization of intangibles    | 166           | —           | 22            | 144          |
| Unallocated corporate expenses | 15,481        | 15,481      | —             | —            |
| Operating income (loss)        | \$ 6,107      | \$ (15,481) | \$ 20,172     | \$ 1,416     |

Revenues attributable to domestic and foreign operations for the six months ended June 30, 2011 and 2010, follows:

|                      | June 30,         |                  |
|----------------------|------------------|------------------|
|                      | 2011             | 2010             |
| United States        | \$ 47,945        | \$ 41,195        |
| United Kingdom       | 7,994            | 5,147            |
| Other countries      | 6,295            | 5,364            |
| <b>Total revenue</b> | <b>\$ 62,234</b> | <b>\$ 51,706</b> |

Long-lived assets by geographic region follows:

|                                | June 30, 2011    | December 31, 2010 |
|--------------------------------|------------------|-------------------|
| United States                  | \$ 29,309        | \$ 29,352         |
| Israel                         | 14,024           | 13,736            |
| United Kingdom                 | 2,214            | 2,358             |
| <b>Total long-lived assets</b> | <b>\$ 45,547</b> | <b>\$ 45,446</b>  |



## (G) GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the six months ended June 30, 2011 are as follows:

|  | Total     | Business  | Consumer |
|--|-----------|-----------|----------|
| Balance as of December 31, 2010          | \$ 24,015 | \$ 15,991 | \$ 8,024 |
| Adjustments to goodwill:                 |           |           |          |
| Contingent earnout payments (see Note 3) | 75        | 75        | —        |
| Balance as of June 30, 2011              | \$ 24,090 | \$ 16,066 | \$ 8,024 |

The changes in the carrying amount of goodwill for the year ended December 31, 2010 are as follows:

|  | Total     | Business  | Consumer |
|--|-----------|-----------|----------|
| Balance as of December 31, 2009          | \$ 23,920 | \$ 15,896 | \$ 8,024 |
| Adjustments to goodwill:                 |           |           |          |
| Contingent earnout payments (see Note 3) | 95        | 95        | —        |
| Balance as of December 31, 2010          | \$ 24,015 | \$ 15,991 | \$ 8,024 |

Intangible assets are summarized as follows (see Note 3):

## Acquired Intangible Assets

|                               | Gross Carrying Amount | As of June 30, 2011<br>Weighted Average Amortization Period | Accumulated Amortization |
|-------------------------------|-----------------------|---|--------------------------|
| Amortizing intangible assets: |                       |   |                          |
| Technology                    | \$ 6,199              | 3.8 years   | \$ 5,102                 |
| Customer contracts            | 2,400                 | 3.0 years   | 2,400                    |
| Trade names                   | 630                   | 3.0 years   | 630                      |
| Non-compete agreements        | 410                   | 1.2 years   | 410                      |
| Patents                       | 475                   | 11.0 years  | 83                       |
| Other                         | 235                   | 3.0 years   | 235                      |
| Total                         | \$ 10,349             |   | \$ 8,860                 |

|                               | Gross Carrying Amount | As of December 31, 2010<br>Weighted Average Amortization Period | Accumulated Amortization |
|-------------------------------|-----------------------|---|--------------------------|
| Amortizing intangible assets: |                       |   |                          |
| Technology                    | \$ 6,199              | 3.8 years   | \$ 4,489                 |
| Customer contracts            | 2,400                 | 3.0 years   | 2,400                    |
| Trade names                   | 630                   | 3.0 years   | 630                      |
| Non-compete agreements        | 410                   | 1.2 years   | 410                      |
| Patents                       | 475                   | 11.0 years  | 61                       |
| Other                         | 235                   | 3.0 years   | 235                      |
| Total                         | \$ 10,349             |   | \$ 8,225                 |



Amortization expense is calculated on a straight-line basis over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was \$318 and \$635 for the three and six months ended June 30, 2011, respectively, and \$389 and \$778 for the three and six months ended June 30, 2010, respectively. Estimated amortization expense for the next five years is: \$329 in 2011, \$43 in 2012, \$43 in 2013, \$43 in 2014, \$43 in 2015 and \$988 thereafter.

#### (H) RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2011, the FASB issued Accounting Standards Update (ASU) 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income" which requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. This update, which should be applied retrospectively, is effective for annual periods beginning after December 15, 2011. The Company is still evaluating whether to present other comprehensive income in a single continuous statement of comprehensive income or in two separate but consecutive statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification (Codification) in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company is currently assessing the impact of this update on its consolidated financial statements.

In December 2010, the FASB has issued ASU No. 2010-28, Intangibles — Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU reflects the decision reached in EITF Issue No. 10-A. The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption was not permitted. This update will have an impact on the Company's accounting in the future for any reporting units with zero or negative carrying amounts.

#### (2) BALANCE SHEET COMPONENTS

Property and Equipment

Property and equipment is summarized as follows:

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|  | June 30, 2011 | December 31, 2010 |
|--|---------------|-------------------|
| Computer equipment and software                | \$ 26,712     | \$ 25,002         |
| Furniture, equipment and building improvements | 4,065         | 1,856             |
|  | 30,777        | 26,858            |
| Less accumulated depreciation                  | 17,321        | 14,096            |
| Total  | \$ 13,456     | \$ 12,762         |

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## Accrued Expenses

Accrued expenses consist of the following:

|  | June 30, 2011    | December 31, 2010 |
|--|------------------|-------------------|
| Payroll and other employee related costs                   | \$ 4,539         | \$ 6,973          |
| Professional services and consulting and other vendor fees | 4,437            | 4,211             |
| Sales commissions  | 539              | 565               |
| Other  | 485              | 362               |
| <b>Total</b>   | <b>\$ 10,000</b> | <b>\$ 12,111</b>  |

## (3) ACQUISITIONS

## Proficient Systems

On July 18, 2006, the Company acquired Proficient Systems, Inc. (“Proficient”), a provider of hosted proactive chat solutions that help companies generate revenue on their web sites. This transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of Proficient were included in the Company’s consolidated results of operations from the date of acquisition. The acquisition added several U.K. based financial services clients and provided an innovative product marketing team. During the six months ended June 30, 2011, the Company incurred additional costs related to the earn-out litigation in the amount of \$75, resulting in an increase in goodwill. During the twelve months ended December 31, 2010, the Company incurred additional costs related to the earn-out litigation in the amount of \$95, resulting in an increase in goodwill.

Based on the achievement of certain revenue targets as of March 31, 2007, LivePerson was contingently required to issue up to an additional 2,050,000 shares of common stock. Based on these targets, the Company issued 1,127,985 shares of common stock valued at \$8,894, based on the quoted market price of the Company’s common stock on the date the contingency was resolved, and made a cash payment of \$20 related to this contingency. At March 31, 2007, the value of these shares has been allocated to goodwill with a corresponding increase in equity. In accordance with the purchase agreement, the earn-out consideration was subject to review by Proficient’s Shareholders’ Representative. On July 31, 2007, the Company was served with a complaint filed in the United States District Court for the Southern District of New York by the Shareholders’ Representative of Proficient (“Plaintiff”). The complaint filed by the Shareholders’ Representative sought certain documentation relating to calculation of the earn-out consideration, and demanded payment of damages on the grounds that substantially all of the remaining contingently issuable earn-out shares should have been paid. The Company believes the claims are without merit. The case proceeded to trial, which ended on November 4, 2010. Post-trial filings were made on November 19, 2010. The Court has still not issued its ruling in this case. In the event that the Court finds in whole or in part for Plaintiff, the Company would be required to pay monetary damages in the amount held by the Court to have been underpaid in the earn-out. The Company is presently unable to reasonably estimate the amount of actual damages, if any, that will be awarded by the Court. If the Court were to find in favor of Plaintiff on every claim at issue in the litigation, the maximum potential damages award would be approximately \$6,000. Should the Company be required to pay any damages award, the associated expense would be allocated to goodwill in connection with Proficient acquisition.

## NuConomy Ltd.

On April 13, 2010, the Company acquired all of the outstanding shares of NuConomy Ltd. (“NuConomy”), an Israeli-based development-stage company whose web analytics and optimization platform is intended to help companies better assess and understand website and social marketing performance, in exchange for aggregate cash consideration of \$800. This transaction was accounted for as an asset purchase. The net asset was allocated to

“Intangibles, net.”

(4) FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted ASC 820-10, Fair Value Measurements, for financial assets and liabilities. This ASC defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. The ASC indicates, among other things, that a fair value measurement assumes a transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The Company adopted the provisions of ASC 820-10 with respect to its non-financial assets and liabilities during the first quarter of fiscal 2009. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a hierarchy for observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

On a nonrecurring basis, the Company uses fair value measures when analyzing asset impairment. Long-lived tangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If it is determined such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization periods, their carrying values are reduced to estimated fair value. The Company uses an income approach and inputs that constitute level 3. During the third quarter of each year, the Company evaluates goodwill for impairment at the reporting unit level. The Company uses a combination of discounted cash flows, prior transactions and quoted price methods to determine the fair market value of the reporting unit. This measurement is classified based on level 3 input.

#### (5) COMMITMENTS AND CONTINGENCIES

The Company leases facilities and certain equipment under agreements accounted for as operating leases. These leases generally require the Company to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the three and six months ended June 30, 2011 was approximately \$1,777 and \$3,466, respectively. Rental expense for operating leases for the three and six months ended June 30, 2010 was approximately \$1,749 and \$3,177, respectively.

#### Employee Benefit Plans

The Company has a 401(k) defined contribution plan covering all eligible employees. The Company provides for employer matching contributions equal to 50% of employee contributions, up to the lesser of 5% of eligible compensation or \$6. Matching contributions are deposited in to the employees 401(k) account and are subject to 5 year graded vesting. Salaries and related expenses include \$146 and \$296 of employer matching contributions for the three and six months ended June 30, 2011, respectively. Salaries and related expenses include \$104 and \$244 of employer matching contributions for the three and six months ended June 30, 2010, respectively.

#### (6) LEGAL MATTERS

On July 31, 2007, the Company was served with a complaint filed in the United States District Court for the Southern District of New York by the Shareholders' Representative of Proficient Systems, Inc. In connection with the July 2006 acquisition of Proficient, the Company was contingently required to issue up to 2,050,000 shares of common stock based on the terms of an earn-out provision in the merger agreement. In accordance with the terms of the earn-out provision, the Company issued 1,127,985 shares of LivePerson common stock in the second quarter of 2007 to the former shareholders of Proficient. The amended complaint filed by the Shareholders' Representative, or Plaintiff, on May 12, 2009 alleges that the Company breached the merger agreement by failing to properly account for net annualized revenue, and demands payment of damages on the grounds that substantially all of the remaining

contingently issuable earn-out shares should have been paid. The Company believes the claims are without merit. The case proceeded to trial, which ended on November 4, 2010. Post-trial filings were made on November 19, 2010. The Court has still not issued its ruling in this case. In the event that the Court finds in whole or in part for Plaintiff, the Company would be required to pay monetary damages in the amount held by the Court to have been underpaid in the earn-out. The Company is presently unable to reasonably estimate the amount of actual damages, if any, that will be awarded by the Court. If the Court were to find in favor of Plaintiff on every claim at issue in the litigation, the maximum potential damages award would be approximately \$6,000. Should the Company be required to pay any damages award, the associated payment would be allocated to goodwill in connection with Proficient acquisition.

On November 3, 2010, Gemini IP LLC filed an amended complaint in a suit pending in the United States District Court for the Eastern District of Texas, adding patent infringement allegations against the Company and various other defendants, including LANDesk Software, Inc., Saba Software, Inc., Genesys S.A. d/b/a Genesys Conferencing, Genesys Conferencing, Inc., Avaya Inc., Best Buy Co., Inc., Bomgar Corporation, ConnectWise, Inc., Elsinore Technologies Inc., GFI Software Ltd., GFI USA, Inc., GFI Software Development, Ltd., LogMeIn, Inc., N-able Technologies Incorporated, NTR Global, Venti Solutions, LLC, Zoho Corporation, Zenith Infotech Ltd., International Business Machines Corp., Samsung Electronics America, Inc., Samsung Electronics Co., Ltd., Samsung Telecommunications America, LLC, AT&T, Inc., Sony Corporation, and Sony Corporation of America. Gemini seeks damages for past infringement, and an injunction against future infringement of the patent in suit. The Company believes Gemini's claims are without merit. On January 10, 2011, the Company answered the complaint, asserting numerous affirmative defenses including non-infringement and invalidity of the patent in suit, and we also counterclaimed for a declaratory judgment of non-infringement and invalidity of the patent in suit. The Court held an initial scheduling conference in this matter on June 1, 2011, and thereafter issued a scheduling order in the case including a final pre-trial conference date of September 5, 2012. At present, the Company and Gemini are discussing potential settlement of this dispute. If those discussions do not result in settlement, the Company intends to vigorously defend against Gemini's allegations, and vigorously pursue our counterclaims. The Company has not accrued for this contingency as of June 30, 2011 because the amount of loss, if any, cannot be reasonably estimated at this time.

On June 15, 2011, the Company filed suit against Lodsys, LLC, in the United States District Court for the Northern District of Illinois, seeking a declaratory judgment that the Company's products do not infringe four patents which Lodsys had previously asserted were infringed by the Company's customers, as well as a declaratory judgment that those four patents are invalid. On July 5, 2011, Lodsys moved to dismiss the Illinois case based on lacking personal jurisdiction, and also countersued the Company and other plaintiffs in similarly-situated declaratory judgment actions, including DriveTime Automotive Group, Inc., ESET, LLC, ForeSee Results, LLC, OpinionLab, Inc., and The New York Times Company, in the United States District Court for the Eastern District of Texas. In the Texas case, Lodsys alleges that the Company infringes one of the patents involved in the co-pending Illinois case, and seeks damages for past infringement, and an injunction against future infringement. The Company believes Lodsys's claims are without merit. In Illinois, the Company (and other similarly-situated plaintiffs) has asked the Court for discovery on jurisdictional and venue issues in advance of briefing their oppositions to the pending motions to dismiss. The Company intends to vigorously defend against Lodsys's allegations of infringement, and vigorously pursue our claims that the asserted patents are invalid and not infringed by the Company's products. The Company has not accrued for this contingency as of June 30, 2011, because the amount of loss, if any, cannot be reasonably estimated at this time.

From time to time, the Company is involved in other legal proceedings arising in the ordinary course of its business. While the Company cannot assure you as to the ultimate outcome of any legal proceedings, the Company is not currently a party to any other legal proceeding that management believes would have a material adverse effect on its financial position or results of operations.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

#### GENERAL

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which are prepared in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that management believes are reasonable based upon the information available. We base these estimates on our historical experience, future expectations and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments that may not be readily apparent from other sources. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions relate to estimates of the carrying amount of goodwill, intangibles, stock based-compensation, valuation allowances for deferred income taxes, accounts receivable, the expected term of a client relationship, accruals and other factors. We evaluate these estimates on an ongoing basis. Actual results could differ from those estimates under different assumptions or conditions, and any differences could be material.

#### OVERVIEW

LivePerson provides online engagement solutions that facilitate real-time assistance and expert advice. We are organized into two operating segments. The Business segment facilitates real-time online interactions — chat, voice/click-to-call, email and self-service/knowledgebase for global corporations of all sizes. The Consumer segment facilitates online transactions between independent service providers (“Experts”) and individual consumers (“Users”) seeking help on the Web. We were incorporated in the State of Delaware in November 1995 and the LivePerson service was introduced initially in November 1998.

In order to sustain growth in these segments, our strategy is to expand our position as the leading provider of online engagement solutions that facilitate real-time assistance and expert advice. To accomplish this, we are focused on the following current initiatives:

- **Expanding Business with Existing Customers and Adding New Customers.** We are expanding our sales capacity by adding enterprise sales agents, and we have recently established a midmarket sales group focused on adding new customers that are larger than our typical SMB customers, but smaller than our typical enterprise customers. We have also expanded our efforts to retain existing SMB customers through increased interaction with them during the early stages of their usage of our services.
- **Introducing New Products and Capabilities.** We are investing in product marketing, R&D and executive personnel to support our expanding efforts to build and launch new products and capabilities to support existing customer deployments, and to further penetrate our total addressable market. These investments are initially focused in the areas of online marketing engagement and chat transcript text analysis. Over time, we expect to develop and launch additional capabilities that leverage our existing market position as a leader in proactive, intelligence-driven online engagement.
- **Creating and Supporting an Open Development Platform.** We have recently introduced an open development platform capability, supported by a community and developer tools that enable third-party developers to create and

deliver new applications that leverage our existing customer base and proactive engagement technology. By creating and supporting this platform, we expect to enable both independent developers and R&D personnel within our customer base to accelerate their product development and innovation, and to expand the value and usage of our current and future products and capabilities.

- Expanding our international presence. We continue to increase our investment in sales and support personnel in the United Kingdom and Western Europe, particularly France and Germany. We are also working with sales and support partners as we expand our investment in the Asia-Pacific region. We continue to improve the multi-language and translation capabilities within our hosted solutions to further support international expansion.

## SECOND QUARTER 2011

Financial overview of the three months ended June 30, 2011 compared to the three months ended June 30, 2010:

- Revenue increased 21% to \$31.9 million from \$26.4 million.
- Operating expenses increased 20% to \$28.5 million from \$23.8 million.
- Net income increased 36% to \$2.2 million from \$1.6 million.

The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating the reported consolidated financial results include the following:

### REVENUE RECOGNITION

The majority of our revenue is generated from monthly service revenues and related professional services from the sale of the LivePerson services. Because we provide our application as a service, we follow the provisions of ASC 605-10-S99, "Revenue Recognition" and ASC 605-25, "Revenue Recognition with Multiple-Element Arrangements." We charge a monthly fee, which varies by type of service, the level of client usage and website traffic, and in some cases, the number of orders placed via our online engagement solutions.

For certain of our larger clients, we may provide call center labor through an arrangement with one or more of several qualified partners. For most of these clients, we pass the fee we incur with the labor provider and our fee for the hosted services through to our customers in the form of a fixed fee for each order placed via our online engagement solutions. For these arrangements, we recognize revenue net of the labor provider's fee in accordance with ASC 605-45, "Principal Agent Considerations," due to the fact that we perform as an agent without risk of loss for collection.

The majority of our larger clients also pay a professional services fee related to implementation. We defer these implementation fees and associated direct costs and recognize them ratably over the expected term of the client relationship upon commencement of the hosting services. We may also charge professional service fees related to additional training, business consulting and analysis in support of the LivePerson services.

We also sell certain of the LivePerson services directly via Internet download. These services are marketed as LivePerson Pro and LivePerson Contact Center for small and mid-sized businesses ("SMBs"), and are paid for almost exclusively by credit card. Credit card payments accelerate cash flow and reduce our collection risk, subject to the merchant bank's right to hold back cash pending settlement of the transactions. Sales of LivePerson Pro and LivePerson Contact Center may occur with or without the assistance of an online sales representative, rather than through face-to-face or telephone contact that is typically required for traditional direct sales.

We recognize monthly service revenue based upon the fee charged for the LivePerson services, provided that there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable. Our service agreements typically have twelve month terms and are terminable or may terminate upon 30 to 90 days' notice without penalty. When professional service fees add value to the customer on a standalone basis, we recognize professional service fees upon completion and customer acceptance in accordance with FASB Accounting Standards Update 2009-13. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. If a professional services arrangement does not qualify for separate accounting, we recognize the fees, and the related labor costs, ratably over a period of 48 months, representing our current estimate of the term of the client relationship.





For revenue generated from online transactions between Experts and Users, we recognize revenue net of Expert fees in accordance with ASC 605-45, "Principal Agent Considerations," due to the fact that we perform as an agent without any risk of loss for collection. We collect a fee from the consumer and retain a portion of the fee, and then remit the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable.

#### STOCK-BASED COMPENSATION

We follow ASC 718-10, "Stock Compensation," which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. ASC 718-10 requires measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized.

As of June 30, 2011, there was approximately \$20.9 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of approximately 2.2 years.

#### ACCOUNTS RECEIVABLE

Our customers are located primarily in the United States. We perform ongoing credit evaluations of our customers' financial condition (except for customers who purchase the LivePerson services by credit card via Internet download) and have established an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information that we believe to be reasonable, although they may change in the future. If there is a deterioration of a customer's credit worthiness or actual write-offs are higher than our historical experience, our estimates of recoverability for these receivables could be adversely affected.

Though our concentration of credit risk is limited due to our large number of customers, we do have several large customers. If we experience a significant write-off from one of these large customers, it could have a material adverse impact on our consolidated financial statements. No single customer accounted for or exceeded 10% of our total revenue in the three and six months ended June 30, 2011 and 2010. One customer accounted for approximately 19% of accounts receivable as of June 30, 2011. One customer accounted for approximately 22% of accounts receivable at December 31, 2010. During the six months ended June 30, 2011, we increased our allowance for doubtful accounts by \$120,000 to \$681,000, principally due to an increase in accounts receivable as a result of increased sales and, to a lesser extent, to an increase in the proportion of our receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles.

## GOODWILL

In accordance with ASC 350-10, “Goodwill and Other Intangible Assets,” goodwill and indefinite-lived intangible assets are not amortized, but reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value below its carrying amount. Goodwill is required to be tested for impairment at least annually. Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. To assist in the process of determining goodwill impairment, we will obtain appraisals from an independent valuation firm. In addition to the use of an independent valuation firm, we will perform internal valuation analyses and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions including projected future cash flows (including timing), discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, determination of appropriate market comparables and the determination of whether a premium or discount should be applied to comparables.

## IMPAIRMENT OF LONG-LIVED ASSETS

In accordance with ASC 360-10, “Accounting for the Impairment or Disposal of Long-lived Assets,” long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying value of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying value of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying value or the fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

## USE OF ESTIMATES

The preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the U.S. requires our management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. Significant items subject to such estimates and assumptions include the carrying amount of goodwill, intangibles, stock-based compensation, valuation allowances for deferred income tax assets, accounts receivable, the expected term of a client relationship, accruals and other factors. Actual results could differ from those estimates.

## RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2011, the FASB issued Accounting Standards Update (ASU) 2011-05, “Comprehensive Income (Topic 220): Presentation of Comprehensive Income” which requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that

should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. This update, which should be applied retrospectively, is effective for annual periods beginning after December 15, 2011. We are still evaluating whether to present other comprehensive income in a single continuous statement of comprehensive income or in two separate but consecutive statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term “fair value.” The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification (Codification) in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. We are currently assessing the impact of this update on our consolidated financial statements.

In December 2010, the FASB has issued ASU No. 2010-28, Intangibles — Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU reflects the decision reached in EITF Issue No. 10-A. The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption was not permitted. This update will have an impact on our accounting in the future for any reporting units with zero or negative carrying amounts.

## REVENUE

The majority of our revenue is generated from monthly service revenues and related professional services from the sale of the LivePerson services. We charge a monthly fee, which varies by service and client usage. The majority of our larger clients also pay a professional services fee related to implementation. A large proportion of our revenue from new clients comes from large corporations. These companies typically have more significant implementation requirements and more stringent data security standards. Such clients also have more sophisticated data analysis and performance reporting requirements, and are likely to engage our professional services organization to provide such analysis and reporting on a recurring basis.

Revenue from our Business segment accounted for 88% of total revenue for the three and six months ended June 30, 2011, respectively. Revenue attributable to our monthly hosted Business services accounted for 95% of total Business revenue for the three and six months ended June 30, 2011, respectively. Revenue from our Business segment accounted for 87% of total revenue for the three and six months ended June 30, 2010, respectively. Revenue attributable to our monthly hosted Business services accounted for 95% of total Business revenue for the three and six months ended June 30, 2010, respectively. Our service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days' notice without penalty. Given the time required to schedule training for our clients' operators and our clients' resource constraints, we have historically experienced a lag between signing a client contract and recognizing revenue from that client. This lag has recently ranged from 30 to 90 days.

Revenue from our Consumer segment is generated from online transactions between Experts and Users and is recognized net of Expert fees and accounted for approximately 12% of total revenue for the three and six months ended June 30, 2011, respectively. Revenue generated from online transactions between Experts and Users accounted for approximately 13% of total revenue for the three and six months ended June 30, 2010, respectively.

We also have entered into contractual arrangements that complement our direct sales force and online sales efforts. These are primarily with call center service companies, pursuant to which LivePerson is paid a commission based on revenue generated by these service companies from our referrals. To date, revenue from such commissions has not been material.

## OPERATING EXPENSES

Our cost of revenue consists of:

- compensation costs relating to employees who provide customer support and implementation services to our clients;
  - compensation costs relating to our network support staff;
  - depreciation of certain hardware and software;
  - allocated occupancy costs and related overhead;
- the cost of supporting our infrastructure, including expenses related to server leases, infrastructure support costs and Internet connectivity;
- the credit card fees and related payment processing costs associated with the consumer and SMB services; and
  - amortization of certain intangibles.

Our product development expenses consist primarily of compensation and related expenses for product development personnel, allocated occupancy costs and related overhead, outsourced labor and expenses for testing new versions of our software. Product development expenses are charged to operations as incurred.

Our sales and marketing expenses consist of compensation and related expenses for sales personnel and marketing personnel, online marketing, allocated occupancy costs and related overhead, advertising, sales commissions, public relations, promotional materials, travel expenses and trade show exhibit expenses.

Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, legal and human resources personnel, allocated occupancy costs and related overhead, professional fees, provision for doubtful accounts and other general corporate expenses.

During the six months ended June 30, 2011, we increased our allowance for doubtful accounts by \$120,000 to \$681,000, principally due to an increase in accounts receivable as a result of increased sales and, to a lesser extent to an increase in the proportion of our receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. During 2010, we increased our allowance for doubtful accounts by \$166,000 to approximately \$561,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. We base our allowance for doubtful accounts on specifically identified credit risks of customers, historical trends and other information that we believe to be reasonable. We adjust our allowance for doubtful accounts when accounts previously reserved have been collected.

## NON-CASH COMPENSATION EXPENSE

The net non-cash compensation amounts for the three and six months ended June 30, 2011 and 2010 consist of:

|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2011                           | 2010    | 2011                         | 2010    |
| Stock-based compensation expense related to ASC 718-10 | \$1,679                        | \$1,086 | \$3,214                      | \$2,173 |

|       |         |         |         |         |
|-------|---------|---------|---------|---------|
| Total | \$1,679 | \$1,086 | \$3,214 | \$2,173 |
|-------|---------|---------|---------|---------|

RESULTS OF OPERATIONS

The Company is organized into two operating segments. The Business segment facilitates real-time online interactions — chat, voice/click-to-call, email and self-service/knowledgebase for global corporations of all sizes. The Consumer segment facilitates online transactions between Experts and Users.

Comparison of Three and Six Months Ended June 30, 2011 and 2010

**Revenue – Business.** Revenue increased by 22% to \$28.1 million and \$54.8 million in the three and six months ended June 30, 2011, respectively, from \$23.0 million and \$44.8 million in the comparable periods in 2010. This increase is primarily attributable to revenue from new clients in the amount of approximately \$2.5 million and \$5.3 million, respectively, increased revenue from existing clients who increased their use of services in the amount of approximately \$2.4 million and \$4.3 million, respectively, net of cancellations, and to a lesser extent, to professional services revenue of approximately \$233,000 and \$436,000, respectively. Our revenue growth has typically been driven by a mix of revenue from new clients as well as expansion of existing clients.

**Revenue – Consumer.** Revenue increased by 9% and 7% to \$3.7 million and \$7.4 million in the three and six months ended June 30, 2011, respectively, from \$3.4 million and \$6.9 million in the comparable periods in 2010. This increase is primarily attributable to an increase in gross revenue of approximately \$243,000 and \$346,000, respectively, as a result of an increase in the rates charged by Experts. In addition, net revenue also increased due to an increase in the fees we charge the Experts of approximately \$64,000 and \$161,000, respectively.

**Cost of Revenue - Business.** Cost of revenue consists of compensation costs relating to employees who provide customer service to our clients, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure and allocated occupancy costs and related overhead. Cost of revenue increased by 23% and 25% to \$7.7 million and \$14.9 million in the three and six months ended June 30, 2011, respectively, from \$6.3 million and \$11.9 million in the comparable periods in 2010. The increase is primarily attributable to an increase in total compensation and related costs for additional and existing customer service and network operations personnel in the amount of approximately \$721,000 and \$1.5 million, respectively, and an increase for primary and backup server facilities and allocated overhead related costs of supporting our server and network infrastructure of approximately \$612,000 and \$1.3 million, respectively. This increase in cost of revenue in excess of revenue growth was driven primarily by increased investment in more robust business continuity capabilities within our hosting facilities. In addition, costs related to data collection and storage has increased, as we have improved the scope and quality of the analytical reporting we provide to our larger customers.

**Cost of Revenue - Consumer.** Cost of revenue consists of compensation costs relating to employees who provide customer service to Experts and Users, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure, credit card and transaction processing fees and related costs, and allocated occupancy costs and related overhead. Cost of revenue increased by 8% to \$997,000 in the three months ended June 30, 2011 from \$928,000 in the comparable period in 2010. This increase is primarily attributable to an increase in credit card and transaction processing fees of approximately \$26,000 and an increase in allocated occupancy costs and related overhead of approximately \$22,000. Costs of revenue remained flat at \$1.9 million in the six months ended June 30, 2011 compared to the comparable period in 2010.

**Product Development.** Our product development expenses consist primarily of compensation and related expenses for product development personnel as well as allocated occupancy costs and related overhead. Product development costs increased by 28% and 25% to \$5.0 million and \$9.4 million in the three and six months ended June 30, 2011, respectively, from \$3.9 and \$7.5 million in the comparable periods in 2010. This increase is primarily attributable to an increase in compensation and related costs for additional and existing product development personnel as a result of our increased efforts to expand our product offerings of approximately \$1.1 million and \$1.9 million, respectively.



**Sales and Marketing - Business.** Our sales and marketing expenses consist of compensation and related expenses for sales and marketing personnel, as well as advertising, public relations, trade show exhibit expenses and allocated occupancy costs and related overhead. Sales and marketing expenses increased by 17% and 19% to \$7.8 million and \$15.1 million in the three and six months ended June 30, 2011, respectively, from \$6.7 million and \$12.7 million in the comparable periods in 2010. This increase is primarily attributable to an increase in compensation and related costs for additional and existing sales and marketing personnel of approximately \$1.0 million and \$2.0 million, respectively, and an increase in allocated occupancy cost and related overhead in the amount of approximately \$208,000 and \$321,000, respectively. This increase relates to our continued efforts to enhance our brand recognition and increase sales lead activity.

**Sales and Marketing - Consumer.** Our sales and marketing expenses consist of compensation and related expenses for marketing personnel, as well as online promotion, public relations, trade show exhibit expenses and allocated occupancy costs and related overhead. Sales and marketing expenses decreased by 13% and 10% to \$1.6 million and \$3.1 million in the three and six months ended June 30, 2011, respectively, from \$1.8 million and \$3.5 million in the comparable periods in 2010. This decrease is primarily attributable to a decrease in compensation and related costs and allocated overhead for marketing personnel of approximately \$167,000 and \$274,000, respectively, and to decreased advertising and promotional expenses of approximately \$40,000 and \$75,000, respectively, driven by improved efficiency in search engine optimization.

**General and Administrative.** Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, legal, human resources and administrative personnel. General and administrative expenses increased by 29% and 17% to \$5.4 and \$9.3 million in the three and six months ended June 30, 2011, respectively, from \$4.2 million and \$8.0 million in the comparable periods in 2010. This increase is primarily attributable to increases in recruiting and related costs, rent, legal and other professional fees in the amount of approximately \$539,000 and \$722,000, respectively, and increases in costs related to additional and existing personnel in the amount of approximately \$497,000 and \$605,000, respectively.

**Amortization of Intangibles.** Amortization expense was \$11,000 and \$22,000 in the three and six months ended June 30, 2011, respectively, and relates to the purchase of patents in August 2009. Amortization expense was \$83,000 and \$166,000 in the three and six months ended June 30, 2010, respectively, and relates primarily to acquisition costs recorded as a result of our acquisition of Kasamba in October 2007. This decrease is attributable to the fact that a portion of the intangible assets related to the Kasamba acquisition was fully amortized in 2010. Additional amortization expense in the amount of \$306 and \$613 are included in cost of revenue for the three and six months ended June 30, 2011, respectively. Amortization expense is expected to be approximately \$1.0 million in the year ended December 31, 2011.

**Other Income (Expense).** Financial income was \$208,000 and \$363,000 in the three and six months ended June 30, 2011, respectively, and relates to favorable currency rate movements of our NIS deposits. Financial expense was \$41,000 and \$90,000 in the three and six months ended June 30, 2010, respectively, and relates to unfavorable currency rate movements related of our NIS deposits. Interest income was \$16,000 and \$30,000 in the three and six months ended June 30, 2011, respectively, compared to \$30,000 and \$53,000 in the comparable periods in 2010, respectively, and consists of interest earned on cash and cash equivalents. These decreases are primarily attributable to decrease in short-term interest rates partially offset by increases in cash and cash equivalents.

**Provision for Income Taxes.** Our effective tax rate was 39% for the three and six months ended June 30, 2011, resulting in a provision for income taxes of \$1.4 million and \$3.4 million in the three and six months ended June 30, 2011, respectively. Our effective tax rate was 38% for the three and six months ended June 30, 2010, respectively, resulting in a provision for income taxes of \$975,000 and \$2.3 million in the comparable periods in 2010, respectively.

Net Income. We had net income of \$2.2 million and \$5.4 million in the three and six months ended June 30, 2011, as compared to net income of \$1.6 million and \$3.8 million for the comparable periods in 2010, respectively. Revenue increased by \$5.5 million and \$10.5 million, respectively, while operating expenses increased by \$4.7 million and \$8.2 million, respectively, other income increased \$235,000 and \$430,000, respectively, and provision for income taxes increased by approximately \$427,000 and \$1.1 million, contributing to a net increase in income from operations of approximately \$580,000 and \$1.7 million in the three and six months ended June 30, 2011, respectively.

## LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2011, we had approximately \$74.4 million in cash and cash equivalents, an increase of approximately \$13.0 million from December 31, 2010.

Net cash provided by operating activities was \$11.8 million for the six months ended June 30, 2011 and consisted primarily of net income, non-cash expenses related to ASC 718-10, amortization of intangibles and depreciation, increases in accounts payable and deferred revenue and decreases in prepaid expenses and other current assets partially offset by an increase in accounts receivable and a decrease in accrued expenses. Net cash provided by operating activities was \$3.6 million for the six months ended June 30, 2010 and consisted primarily of net income, non-cash expenses related to ASC 718-10, amortization of intangibles and depreciation partially offset by an increase in accounts receivable and decreases in accounts payable and accrued expenses.

Net cash used in investing activities was \$4.4 million in the six months ended June 30, 2011, and was due primarily to the build-out of new office space in New York and Israel, and to a lesser extent, to purchases of fixed assets for our collocation facilities. Net cash used in investing activities was \$3.1 million in the six months ended June 30, 2010, and was due primarily to the purchase of fixed assets for our collocation facilities and the acquisition of NuConomy in April 2010.

Net cash provided by financing activities was \$5.6 million for the six months ended June 30, 2011 and consisted primarily of the proceeds from the issuance of common stock in connection with the exercise of stock options by employees and the excess tax benefit from the exercise of employee stock options. Net cash provided by financing activities was \$6.9 million for the six months ended June 30, 2010 and consisted primarily of the excess tax benefit from exercise of employee stock options and the proceeds from issuance of common stock in connection with the exercise of stock options by employees.

We have incurred significant expenses to develop our technology and services, to hire employees in our customer service, sales, marketing and administration departments, and for the amortization of intangible assets, as well as non-cash compensation costs. Historically, we incurred significant quarterly net losses from inception through June 30, 2003, significant negative cash flows from operations in our quarterly periods from inception through December 31, 2002 and negative cash flows from operations of \$124,000 in the three month period ended March 31, 2004. As of June 30, 2011, we had an accumulated deficit of approximately \$94.7 million. These losses have been funded primarily through the issuance of common stock in our initial public offering and, prior to the initial public offering, the issuance of convertible preferred stock.

We anticipate that our current cash and cash equivalents will be sufficient to satisfy our working capital and capital requirements for at least the next 12 months. However, we cannot assure you that we will not require additional funds prior to such time, and we would then seek to sell additional equity or debt securities through public financings, or seek alternative sources of financing. We cannot assure you that additional funding will be available on favorable terms, when needed, if at all. If we are unable to obtain any necessary additional financing, we may be required to further reduce the scope of our planned sales and marketing and product development efforts, which could materially adversely affect our business, financial condition and operating results. In addition, we may require additional funds in order to fund more rapid expansion, to develop new or enhanced services or products or to invest in complementary businesses, technologies, services or products.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

We do not have any special purposes entities, and other than operating leases, which are described below, we do not engage in off-balance sheet financing arrangements.



We lease facilities and certain equipment under agreements accounted for as operating leases. These leases generally require us to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the three and six months ended June 30, 2011 was approximately \$1.8 million and \$3.5 million, respectively, and approximately \$1.7 million and \$3.2 million for the three and six months ended June 30, 2010, respectively.

As of June 30, 2011, our principal commitments were approximately \$20.9 million under various operating leases, of which approximately \$3.6 million is due in 2011. We currently expect that our principal commitments for the year ending December 31, 2011 will not exceed \$8.0 million in the aggregate.

Our contractual obligations at June 30, 2011 are summarized as follows:

|                                | Payments due by period<br>(in thousands) |                     |                 |                |                      |
|--------------------------------|--|---------------------|-----------------|----------------|----------------------|
|                                | Total                                    | Less than 1<br>year | 1-3 years       | 3-5 years      | More than 5<br>years |
| <b>Contractual Obligations</b> |  |                     |                 |                |                      |
| Operating leases               | \$20,851                                 | \$3,560             | \$12,473        | \$2,816        | \$2,002              |
| <b>Total</b>                   | <b>\$20,851</b>                          | <b>\$3,560</b>      | <b>\$12,473</b> | <b>\$2,816</b> | <b>\$2,002</b>       |

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Currency Rate Fluctuations

As a result of the expanded scope of our Israeli operations, our currency rate fluctuation risk associated with the exchange rate movement of the U.S. dollar against the New Israeli Shekel (“NIS”) has increased. During the six months ended June 30, 2011, the U.S. dollar depreciated approximately 4% as compared to the NIS which had a negative impact on our results of operations and financial conditions when compared to the same period in 2010. During the six month period ended June 30, 2011, expenses generated by our Israeli operations totaled \$19.3 million. We do not currently hedge our foreign currency risk exposure. We actively monitor the movement of the U.S. dollar against the NIS and U.K. pound and have considered the use of financial instruments, including but not limited to derivative financial instruments, which could mitigate such risk. If we determine that our risk of exposure materially exceeds the potential cost of derivative financial instruments, we may in the future enter in to these types of investments. The functional currency of our wholly-owned Israeli subsidiaries, LivePerson Ltd. (formerly HumanClick Ltd.) and Kasamba Ltd., is the U.S. dollar and the functional currency of our operations in the United Kingdom is the U.K. pound.

#### Collection Risk

Our accounts receivable are subject, in the normal course of business, to collection risks. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of collection risks. During the six months ended June 30, 2011, we increased our allowance for doubtful accounts \$120,000 to \$681,000, principally due to an increase in accounts receivable as a result of increased sales and, to a lesser extent to an increase in the proportion of our receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. During the six months ended June 30, 2010, we increased our allowance for doubtful accounts \$15,000 to \$410,000, principally due to an increase in accounts receivable as a result of increased sales and, to a lesser extent to an increase in the proportion of our receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles.

Interest Rate Risk

Our investments consist of cash and cash equivalents. Therefore, changes in the market's interest rates do not affect in any material respect the value of the investments as recorded by us.

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## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

Our management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our “disclosure controls and procedures,” as that term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of June 30, 2011. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2011 to ensure that the information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms, and to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2011 identified in connection with the evaluation thereof by our management, including the Chief Executive Officer and Chief Financial Officer, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### Limitations of the Effectiveness of Internal Control

A control system, no matter how well conceived and operated, can only provide reasonable, not absolute, assurance that the objectives of the internal control system are met. Because of the inherent limitations of any internal control system, no evaluation of controls can provide absolute assurance that all control issues, if any, have been detected.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On July 31, 2007, we were served with a complaint filed in the United States District Court for the Southern District of New York by the Shareholders’ Representative of Proficient Systems, Inc. In connection with the July 2006 acquisition of Proficient, we were contingently required to issue up to 2,050,000 shares of common stock based on the terms of an earn-out provision in the merger agreement. In accordance with the terms of the earn-out provision, we issued 1,127,985 shares of LivePerson common stock in the second quarter of 2007 to the former shareholders of Proficient. The amended complaint filed by the Shareholders’ Representative, or Plaintiff, on May 12, 2009 alleges that we breached the merger agreement by failing to properly account for net annualized revenue, and demands payment of damages on the grounds that substantially all of the remaining contingently issuable earn-out shares should have been paid. We believe the claims are without merit. The case proceeded to trial, which ended on November 4, 2010. Post-trial filings were made on November 19, 2010. In the event that the Court finds in whole or in part for Plaintiff, we would be required to pay monetary damages in the amount held by the Court to have been underpaid in the earn-out. We are presently unable to reasonably estimate the amount of actual damages, if any, that will be awarded by the Court. If the Court were to find in favor of Plaintiff on every claim at issue in the litigation, the maximum potential damages award would be approximately \$6.0 million. Should we be required to pay any damages award, the associated payment would be allocated to goodwill in connection with Proficient acquisition.

On November 3, 2010, Gemini IP LLC filed an amended complaint in a suit pending in the United States District Court for the Eastern District of Texas, adding patent infringement allegations against us and various other

defendants, including LANDesk Software, Inc., Saba Software, Inc., Genesys S.A. d/b/a Genesys Conferencing, Genesys Conferencing, Inc., Avaya Inc., Best Buy Co., Inc., Bomgar Corporation, ConnectWise, Inc., Elsinore Technologies Inc., GFI Software Ltd., GFI USA, Inc., GFI Software Development, Ltd., LogMeIn, Inc., N-able Technologies Incorporated, NTR Global, Venti Solutions, LLC, Zoho Corporation, Zenith Infotech Ltd., International Business Machines Corp., Samsung Electronics America, Inc., Samsung Electronics Co., Ltd., Samsung Telecommunications America, LLC, AT&T, Inc., Sony Corporation, and Sony Corporation of America. Gemini seeks damages for past infringement, and an injunction against future infringement of the patent in suit. We believe Gemini's claims are without merit. On January 10, 2011, we answered the complaint, asserting numerous affirmative defenses including non-infringement and invalidity of the patent in suit, and we also counterclaimed for a declaratory judgment of non-infringement and invalidity of the patent in suit. The Court held an initial scheduling conference in this matter on June 1, 2011, and thereafter issued a scheduling order in the case including a final pre-trial conference date of September 5, 2012. At present, we are discussing with Gemini potential settlement of this dispute. If those discussions do not result in settlement, we intend to vigorously defend against Gemini's allegations, and vigorously pursue our counterclaims. We have not accrued for this contingency as of June 30, 2011 because the amount of loss, if any, cannot be reasonably estimated at this time.

On June 15, 2011, we filed suit against Lodsys, LLC, in the United States District Court for the Northern District of Illinois, seeking a declaratory judgment that our products do not infringe four patents which Lodsys had previously asserted were infringed by our customers, as well as a declaratory judgment that those four patents are invalid. On July 5, 2011, Lodsys moved to dismiss the Illinois case based on lacking personal jurisdiction, and also countersued us and other plaintiffs in similarly-situated declaratory judgment actions, including DriveTime Automotive Group, Inc., ESET, LLC, ForeSee Results, LLC, OpinionLab, Inc., and The New York Times Company, in the United States District Court for the Eastern District of Texas. In the Texas case, Lodsys alleges that we infringed one of the patents involved in the co-pending Illinois case, and seeks damages for past infringement, and an injunction against future infringement. We believe Lodsys's claims are without merit. In Illinois, we (and other similarly-situated plaintiffs) have asked the Court for discovery on jurisdictional and venue issues in advance of briefing their oppositions to the pending motions to dismiss. We intend to vigorously defend against Lodsys's allegations of infringement, and vigorously pursue our claims that the asserted patents are invalid and not infringed by our products. We have not accrued for this contingency as of June 30, 2011, because the amount of loss, if any, cannot be reasonably estimated at this time.

From time to time, we are involved in other legal proceedings arising in the ordinary course of our business. While we cannot assure you as to the ultimate outcome of any legal proceedings, we are currently not a party to any other legal proceeding that management believes would have a material adverse effect on our financial position or results of operations.



## ITEM 1A. RISK FACTORS

Risks that could have a material and adverse impact on our business, results of operations and financial condition include the following: potential fluctuations in our quarterly and annual results; the adverse effect that the global recession may have on our business; competition in the real-time sales, marketing, customer service and online engagement solutions market; our ability to retain existing clients and attract new clients; risks related to new regulatory or other legal requirements that could materially impact our business; impairments to goodwill that result in significant charges to earnings; volatility of the value of certain currencies in relation to the U.S. dollar, particularly the New Israeli Shekel, U.K. pound and Euro; risks related to our international operations, particularly our operations in Israel, and the civil and political unrest in that region; responding to rapid technological change and changing client preferences; our ability to retain key personnel and attract new personnel; risks related to the operational integration of acquisitions; technology systems beyond our control and technology-related defects that could disrupt the LivePerson services; privacy concerns relating to the Internet that could result in new legislation or negative public perception; risks related to the regulation or possible misappropriation of personal information; legal liability and/or negative publicity for the services provided to consumers via our technology platforms; risks related to protecting our intellectual property rights or potential infringement of the intellectual property rights of third parties; and risks related to our common stock being traded on more than one market, which may result in additional variations in the trading price of our common stock. This list is intended to identify only certain of the principal factors that could have a material and adverse impact on our business, results of operations and financial condition. A more detailed description of each of these and other important risk factors can be found under the caption "Risk Factors" in our most recent Annual Report on Form 10-K filed on March 15, 2011.

There are no material changes to the risk factors described in the Form 10-K.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On May 14, 2010, our Board of Directors approved a stock repurchase program through June 30, 2012.

The following table summarizes repurchases of our common stock under our stock repurchase program during the quarter ended June 30, 2011:

| Period               | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1) |
|----------------------|----------------------------------|------------------------------|--|---|
| 4/1/2011 – 4/30/2011 | —                                | \$ —                         | —  | \$ 6,365,000  |
| 5/1/2011 – 5/31/2011 | —                                | —                            | —  | 6,365,000   |
| 6/1/2011 – 6/30/2011 | —                                | —                            | —  | 6,365,000   |
| Total                | —                                | \$ —                         | —  | \$ 6,365,000  |

(1) Under the stock repurchase program, we are authorized to repurchase shares of our common stock, in the open market or privately negotiated transactions, at times and prices considered appropriate by our Board of Directors depending upon prevailing market conditions and other corporate

considerations, up to an aggregate purchase price of \$10.0 million. As of June 30, 2011, approximately \$6.4 million remained available for purchases under the program.

ITEM 6. EXHIBITS

The following exhibits are filed as part of this Quarterly Report on Form 10-Q:

- 31.1 Certification by Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification by Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LIVEPERSON, INC.  
(Registrant)

Date: August 8, 2011

By: /s/ ROBERT P. LOCASCIO  
Name: Robert P. LoCascio  
Title: Chief Executive Officer (duly authorized officer)

Date: August 8, 2011

By: /s/ DANIEL R. MURPHY  
Name: Daniel R. Murphy  
Title: Chief Financial Officer (principal financial and accounting officer)

EXHIBIT INDEX

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