

LIVEPERSON INC  
Form 10-Q  
November 07, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended SEPTEMBER 30, 2008**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 0-30141**

**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.)

**462 SEVENTH AVENUE  
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 x No o

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 o Accelerated filer x  
Non-accelerated filer o Smaller reporting company o

(Do not check if a smaller reporting  
company)

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

As of November 3, 2008, there were 47,445,048 shares of the issuer's common stock outstanding.

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**LIVEPERSON, INC.**  
**SEPTEMBER 30, 2008**  
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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. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****LIVEPERSON, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)**

|   | <b>September 30, 2008</b> | <b>December 31, 2007</b> |
|---|---------------------------|--------------------------|
|   | (Unaudited)               | (Note 1(B))              |
| <b>ASSETS</b>   |                           |                          |
| Current assets:   |                           |                          |
| Cash and cash equivalents   | \$ 23,773                 | \$ 26,222                |
| Accounts receivable, net of allowances for doubtful accounts of \$260 and \$208 as of September 30, 2008 and December 31, 2007, respectively  | 6,910                     | 6,026                    |
| Prepaid expenses and other current assets   | 2,270                     | 1,802                    |
| Deferred tax assets, net  | 1,569                     | 42                       |
| <b>Total current assets</b>   | <b>34,522</b>             | <b>34,092</b>            |
| Property and equipment, net   | 7,462                     | 3,733                    |
| Intangibles, net  | 4,898                     | 6,953                    |
| Goodwill  | 47,971                    | 51,684                   |
| Deferred tax assets, net  | 6,336                     | 4,202                    |
| Security deposits   | 385                       | 499                      |
| Other assets  | 1,677                     | 1,325                    |
| <b>Total assets</b>   | <b>\$ 103,251</b>         | <b>\$ 102,488</b>        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                           |                          |
| Current liabilities:  |                           |                          |
| Accounts payable  | \$ 4,022                  | \$ 3,067                 |
| Accrued expenses  | 8,366                     | 9,191                    |
| Deferred revenue  | 4,408                     | 4,000                    |
| Deferred tax liabilities, net   | -                         | 193                      |
| <b>Total current liabilities</b>  | <b>16,796</b>             | <b>16,451</b>            |
| Other liabilities   | 1,677                     | 1,325                    |
| Commitments and contingencies   |                           |                          |
| Stockholders' equity:   |                           |                          |
| Preferred stock, \$.001 par value per share; 5,000,000 shares authorized, 0 shares issued and outstanding at September 30, 2008 and December 31, 2007   | —                         | —                        |
| Common stock, \$.001 par value per share; 100,000,000 shares authorized, 47,300,048 shares issued and outstanding at September 30, 2008 and 47,892,128 shares issued and outstanding at December 31, 2007 | 47                        | 48                       |
| Additional paid-in capital  | 178,143                   | 178,041                  |
| Accumulated deficit   | (93,351)                  | (93,358)                 |
| Accumulated other comprehensive loss  | (61)                      | (19)                     |
| <b>Total stockholders' equity</b>   | <b>84,778</b>             | <b>84,712</b>            |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 103,251</b>         | <b>\$ 102,488</b>        |

**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**

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Revenue  | \$ 19,375                 | \$ 12,823   | \$ 55,048                | \$ 35,453   |
| Operating expenses:  |                           |             |                          |             |
| Cost of revenue  | 5,226                     | 3,305       | 15,346                   | 9,199       |
| Product development  | 3,299                     | 2,169       | 9,876                    | 6,033       |
| Sales and marketing  | 6,624                     | 3,556       | 18,864                   | 10,470      |
| General and administrative   | 3,399                     | 2,274       | 10,034                   | 6,353       |
| Amortization of intangibles  | 352                       | 242         | 1,134                    | 725         |
| Total operating expenses   | 18,900                    | 11,546      | 55,254                   | 32,780      |
| Income (loss) from operations  | 475                       | 1,277       | (206)                    | 2,673       |
| Other (expense) income:  |                           |             |                          |             |
| Financial (expense) income   | (123)                     | 26          | (125)                    | 5           |
| Interest income  | 79                        | 283         | 270                      | 739         |
| Total other (expense) income, net  | (44)                      | 309         | 145                      | 744         |
| Income (loss) before provision for<br>(benefit from) income taxes                                    | 431                       | 1,586       | (61)                     | 3,417       |
| Provision for (benefit from) income<br>taxes   | 21                        | -           | (68)                     | -           |
| Net income   | \$ 410                    | \$ 1,586    | \$ 7                     | \$ 3,417    |
| Basic net income per common share  | \$ 0.01                   | \$ 0.04     | \$ 0.00                  | \$ 0.08     |
| Diluted net income per common<br>share   | \$ 0.01                   | \$ 0.03     | \$ 0.00                  | \$ 0.07     |
| Weighted average shares<br>outstanding used in basic net income<br>per common share calculation      | 47,229,252                | 43,080,475  | 47,433,924               | 42,469,631  |
| Weighted average shares<br>outstanding used in diluted net<br>income per common share<br>calculation | 48,678,016                | 46,328,876  | 49,064,151               | 45,942,436  |

Income (loss) from operations for the three and nine months ended September 30, 2008 includes stock-based compensation expense related to the adoption of SFAS No. 123(R) in the amount of \$1,014 and \$3,178, respectively. Income from operations for the three and nine months ended September 30, 2007 includes stock-based compensation expense related to the adoption of SFAS No. 123(R) in the amount of \$930 and \$2,642, respectively. See Note 1(D).

**SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED  
CONSOLIDATED FINANCIAL STATEMENTS.**

**LIVEPERSON, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)  
UNAUDITED**

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2008</b>                                | <b>2007</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |  |             |
| Net income  | \$ 7                                       | \$ 3,417    |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |             |
| Stock-based compensation expense  | 3,178                                      | 2,642       |
| Depreciation  | 1,324                                      | 585         |
| Amortization of intangibles   | 2,055                                      | 978         |
| Deferred income taxes   | (39)                                       | (3,521)     |
| Provision for doubtful accounts   | 68   | 74          |
| <b>CHANGES IN OPERATING ASSETS AND LIABILITIES:</b>                               |  |             |
| Accounts receivable   | (952)                                      | (1,595)     |
| Prepaid expenses and other current assets   | (468)                                      | 27          |
| Security deposits   | 114  | 13          |
| Accounts payable  | 1,054                                      | 90          |
| Accrued expenses  | (494)                                      | 1,048       |
| Deferred revenue  | 408  | 823         |
| Net cash provided by operating activities   | 6,255                                      | 4,581       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |  |             |
| Purchases of property and equipment, including capitalized software               | (5,393)                                    | (614)       |
| Prepaid acquisition costs   | -  | (122)       |
| Acquisition of Kasamba  | (112)                                      | -           |
| Acquisition of Proficient   | (132)                                      | (218)       |
| Net cash used in investing activities   | (5,637)                                    | (954)       |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |  |             |
| Excess tax benefit from the exercise of employee stock options                    | -  | 3,302       |
| Proceeds from issuance of common stock in connection with the exercise of options | 655  | 1,513       |
| Repurchase of common stock  | (3,680)                                    | -           |
| Net cash (used in) provided by financing activities                               | (3,025)                                    | 4,815       |
| Effect of foreign exchange rate changes on cash and cash equivalents              | (42)                                       | (7)         |
| Net (decrease) increase in cash and cash equivalents                              | (2,449)                                    | 8,435       |
| Cash and cash equivalents at the beginning of the period                          | 26,222                                     | 21,729      |
| Cash and cash equivalents at the end of the period                                | \$ 23,773                                  | \$ 30,164   |

## Supplemental disclosure of non-cash investing activities:

Cash flows from investing for the nine months ended September 30, 2008 does not include the purchases of approximately \$936 of capitalized equipment related to the Company's colocation facility as the corresponding



invoices are included in accounts payable at September 30, 2008, and therefore did not have an impact on cash flows for the period.

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During the nine months ended September 30, 2007, the Company incurred approximately \$650 of acquisition costs related to its acquisition of Kasamba Inc., of this amount, \$527 is included in accrued expenses at September 30, 2007.

During the nine months ended September 30, 2007, the Company issued 1,129,571 shares of common stock, valued at \$8,901, in connection with the acquisition of Proficient Systems, Inc. on July 18, 2006.

During the nine months ended September 30, 2007, the Company reduced the amount of accrued restructuring costs related to the Proficient acquisition in the amount of approximately \$130, net.

**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”) was incorporated in the State of Delaware in 1995. The Company commenced operations in 1996. LivePerson provides online engagement solutions that facilitate real-time assistance and expert advice.

The Company’s primary revenue source is the sale of the LivePerson services under the brand names Timpani and LivePerson. The Company also facilitates online transactions between service providers (“experts”) who provide expert online advice to consumers (“users”). Headquartered in New York City, the Company’s product development staff, help desk, online sales support and the Kasamba operations are located in Israel. The Company also maintains offices in Atlanta and the United Kingdom.

**(B) UNAUDITED CONDENSED CONSOLIDATED FINANCIAL INFORMATION**

The accompanying condensed consolidated financial statements as of September 30, 2008 and for the three and nine months ended September 30, 2008 and 2007 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 September 30, 2008, and the consolidated results of operations and cash flows for the interim periods ended September 30, 2008 and 2007. 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, 2007 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, 2007, included in the Company’s Annual Report on Form 10-K filed with the SEC on March 14, 2008.

**(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 SEC Staff Accounting Bulletin No. 104, “Revenue Recognition” and Emerging Issues Task Force Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables.” The Company charges a monthly fee, which varies by service and client usage. The majority of the Company’s larger clients also pay a professional services fee related to implementation. 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 are terminable upon 30 to 90 days' notice without penalty. When professional service fees provide added value to the customer on a standalone basis and there is objective and reliable evidence of the fair value of each deliverable, the Company recognizes professional service fees upon completion and customer acceptance of key milestones within each of the professional services engagements. 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 36 months, representing the Company's current estimate of the term of the client relationship.

For revenue generated from online transactions between experts and consumers, the Company applies Emerging Issues Task Force ("EITF") 99-19, "Reporting Revenue Gross as a Principle versus Net as an Agent" 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 consumer 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 adopted Statement of Financial Accounting Standards No. 123(R) ("SFAS No. 123(R)") using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year. The Company's Consolidated Financial Statements as of and for the three and nine months ended September 30, 2008 and 2007 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

The following table summarizes stock-based compensation expense related to employee stock options under SFAS No. 123(R) included in Company's Statements of Operations for the three and nine months ended September 30, 2008 and 2007:

|   | Three Months Ended |        | Nine Months Ended |          |
|---|--------------------|--------|-------------------|----------|
|   | September 30,      |        | September 30,     |          |
|   | 2008               | 2007   | 2008              | 2007     |
| Cost of revenue   | \$ 145             | \$ 105 | \$ 420            | \$ 314   |
| Product development expense                                   | 302                | 317    | 1,015             | 858      |
| Sales and marketing expense                                   | 292                | 245    | 881               | 749      |
| General and administrative expense                            | 275                | 263    | 862               | 721      |
| Total stock based compensation included in operating expenses | \$ 1,014           | \$ 930 | \$ 3,178          | \$ 2,642 |

The per share weighted average fair value of stock options granted during the three months ended September 30, 2008 and 2007 was \$1.65 and \$3.28, 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>September 30, |             | Nine Months Ended<br>September 30, |             |
|--------------------------|-------------------------------------|-------------|------------------------------------|-------------|
|                          | 2008                                | 2007        | 2008                               | 2007        |
| Dividend yield           | 0.0%                                | 0.0%        | 0.0%                               | 0.0%        |
| Risk-free interest rate  | 3.9%-4.0%                           | 4.8%-5.3%   | 1.9%-4.0%                          | 4.7%-5.3%   |
| Expected life (in years) | 4.9                                 | 4.2         | 4.2-4.9                            | 4.2         |
| Historical volatility    | 68.5%                               | 73.0%-73.4% | 68.5%-71.5%                        | 73.0%-75.7% |

Prior to the adoption of SFAS No. 123(R) on January 1, 2006, the Company applied the intrinsic value-based method of accounting prescribed by APB Opinion No. 25 and related interpretations including Financial Accounting Standards Board (“FASB”) Interpretation No. 44, “Accounting for Certain Transactions Involving Stock Compensation: An Interpretation of APB Opinion No. 25” (issued in March 2000), to account for its fixed plan stock options. Under this method, compensation expense was recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123 and SFAS No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure” (an amendment to SFAS No. 123), established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As permitted by the accounting standards, the Company had elected to continue to apply the intrinsic value-based method of accounting described above, and had adopted the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148. The Company amortized deferred compensation on a graded vesting methodology in accordance with FASB Interpretation No. 28, “Accounting for Stock Appreciation Rights and Other Variable Stock Award Plans.”

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 Company established a successor to the 1998 Plan, the 2000 Stock Incentive Plan (the “2000 Plan”). Under the 2000 Plan, the options which had been outstanding under the 1998 Plan were incorporated into the 2000 Plan and the Company increased 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. Options to acquire common stock granted thereunder have ten-year terms. Pursuant to the provisions of the 2000 Plan, the number of shares of common stock available for issuance thereunder automatically increases on the first trading day in each calendar year by an amount equal to three percent (3%) of the total number of shares of the Company’s common stock outstanding on the last trading day of the immediately preceding calendar year, but in no event shall such annual increase exceed 1,500,000 shares. As of September 30, 2008, approximately 12,586,000 shares of common stock were reserved for issuance under the 2000 Plan (taking into account all option exercises through September 30, 2008). As of September 30, 2008, there was \$10,487 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 2.3 years.

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

| Options | Weighted<br>Average<br>Exercise Price |
|---------|---------------------------------------|
|---------|---------------------------------------|

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|   |            |    |      |
|---|------------|----|------|
| Options outstanding at December 31, 2007  | 8,997,366  | \$ | 3.72 |
| Options granted                           | 2,265,500  | \$ | 3.25 |
| Options exercised                         | (431,974)  | \$ | 1.52 |
| Options cancelled                         | (690,908)  | \$ | 4.79 |
| Options outstanding at September 30, 2008 | 10,139,984 | \$ | 3.63 |
| Options exercisable at September 30, 2008 | 5,587,263  | \$ | 3.05 |

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The total intrinsic value of stock options exercised during the period ended September 30, 2008 was approximately \$661. The total intrinsic value of options exercisable at September 30, 2008 was approximately \$4,045. The total intrinsic value of options expected to vest is approximately \$188.

A summary of the status of the Company's nonvested shares as of December 31, 2007, and changes during the nine months ended September 30, 2008 is as follows:

|  | Shares      | Weighted<br>Average Grant-<br>Date Fair Value |
|--|-------------|---|
| Nonvested Shares at December 31, 2007  | 4,349,083   | \$ 3.18                                       |
| Granted                                | 2,265,500   | \$ 1.93                                       |
| Vested                                 | (1,465,621) | \$ 2.93                                       |
| Cancelled                              | (596,241)   | \$ 2.88                                       |
| Nonvested Shares at September 30, 2008 | 4,552,721   | \$ 2.79                                       |

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

The Company calculates earnings per share in accordance with the provisions of SFAS No. 128, "Earnings Per Share ("EPS")," and the guidance of the SEC Staff Accounting Bulletin No. 98. Under SFAS No. 128, 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 nine months ended September 30, 2008 includes the effect of options to purchase 2,704,344 and 3,576,467 shares, respectively, of common stock with a weighted average exercise price of \$1.37 and \$1.75, respectively. Diluted net income per common share for the three and nine months ended September 30, 2008 does not include the effect of options to purchase 7,435,640 and 6,563,517 shares, respectively, of common stock. Diluted net income per common share for the three and nine months ended September 30, 2007 includes the effect of options to purchase 5,339,331 and 5,772,956 shares, respectively, of common stock with a weighted average exercise price of \$2.05 and \$2.22, respectively, and warrants to purchase 121,750 shares of common stock with a weighted average exercise price of \$2.01. Diluted net income per common share for the three and nine months ended September 30, 2007 does not include the effect of options to purchase 3,640,725 and 3,207,100 shares, respectively, of common stock. A reconciliation of shares used in calculating basic and diluted earnings per share follows:

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2008                                | 2007       | 2008                               | 2007       |
| Basic   | 47,229,252                          | 43,080,475 | 47,433,924                         | 42,469,631 |
| Effect of assumed exercised<br>options and warrants | 1,448,764                           | 3,248,401  | 1,630,227                          | 3,472,805  |
| Diluted   | 48,678,016                          | 46,328,876 | 49,064,151                         | 45,942,436 |



**(F) SEGMENT REPORTING**

The Company accounts for its segment information in accordance with the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 131 establishes annual and interim reporting standards for operating segments of a company. SFAS No. 131 requires disclosures of selected segment-related financial information about products, major customers, and geographic areas based on the Company's internal accounting methods. Due to the acquisition of Kasamba Inc. in October 2007, the Company is now organized into two operating segments for purposes of making operating decisions and assessing performance. The Company may reorganize its operations in the future when the integration of its products and services are complete. 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 policies used in the preparation of the Company's consolidated financial statements and 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, general and administrative, non cash-compensation expenses and income taxes 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 September 30, 2008, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | <b>Consolidated</b> | <b>Corporate</b>  | <b>Business</b>  | <b>Consumer</b> |
|--------------------------------|---------------------|-------------------|------------------|-----------------|
| <b>Revenue:</b>                |                     |                   |                  |                 |
| Hosted services                | \$ 15,769           | \$ —              | \$ 15,769        | \$ —            |
| Expert advice                  | 2,647               | —                 | —                | 2,647           |
| Professional services          | 959                 | —                 | 959              | —               |
| <b>Total revenue</b>           | <b>\$ 19,375</b>    | <b>\$ —</b>       | <b>\$ 16,728</b> | <b>\$ 2,647</b> |
| Cost of revenue                | 5,226               | —                 | 4,268            | 958             |
| Sales and marketing            | 6,624               | —                 | 4,572            | 2,052           |
| Amortization of intangibles    | 352                 | —                 | 202              | 150             |
| Unallocated corporate expenses | 6,698               | 6,698             | —                | —               |
| <b>Operating income (loss)</b> | <b>\$ 475</b>       | <b>\$ (6,698)</b> | <b>\$ 7,686</b>  | <b>\$ (513)</b> |

Revenues attributable to domestic and foreign operations follows:

|                      |                  |
|----------------------|------------------|
| United States        | \$ 14,888        |
| United Kingdom       | 2,250            |
| Other countries      | 2,237            |
| <b>Total revenue</b> | <b>\$ 19,375</b> |

Summarized financial information by segment for the nine months ended September 30, 2008, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | <b>Consolidated</b> | <b>Corporate</b> | <b>Business</b>  | <b>Consumer</b> |
|--------------------------------|---------------------|------------------|------------------|-----------------|
| <b>Revenue:</b>                |                     |                  |                  |                 |
| Hosted services                | \$ 44,257           | \$ —             | \$ 44,257        | \$ —            |
| Expert advice                  | 8,132               | —                | —                | 8,132           |
| Professional services          | 2,659               | —                | 2,659            | —               |
| <b>Total revenue</b>           | <b>\$ 55,048</b>    | <b>\$ —</b>      | <b>\$ 46,916</b> | <b>\$ 8,132</b> |
| Cost of revenue                | 15,346              | —                | 12,520           | 2,826           |
| Sales and marketing            | 18,864              | —                | 13,356           | 5,508           |
| Amortization of intangibles    | 1,134               | —                | 686              | 448             |
| Unallocated corporate expenses | 19,910              | 19,910           | —                | —               |
| Operating (loss) income        | \$ (206)            | \$ (19,910)      | \$ 20,354        | \$ (650)        |

Revenues attributable to domestic and foreign operations follows:

|                      |                  |
|----------------------|------------------|
| United States        | \$ 42,599        |
| United Kingdom       | 6,135            |
| Other countries      | 6,314            |
| <b>Total revenue</b> | <b>\$ 55,048</b> |

Long-lived assets by geographic region as of September 30, 2008 are as follows:

|                                |                  |
|--------------------------------|------------------|
| United States                  | \$ 28,741        |
| Israel                         | 39,988           |
| <b>Total long-lived assets</b> | <b>\$ 68,729</b> |

#### **(G) GOODWILL AND INTANGIBLE ASSETS**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2008 are as follows:

|   | <b>Total</b> | <b>Business</b> | <b>Consumer</b> |
|---|--------------|-----------------|-----------------|
| Balance as of December 31, 2007                                 | \$ 51,684    | \$ 18,744       | \$ 32,940       |
| Adjustments to goodwill:  |              |                 |                 |
| Release of valuation reserve on deferred tax asset (see Note 3) | (3,873)      | (3,031)         | (842)           |
| Contingent earnout payments                                     | 147          | 147             | -               |
| Other   | 13           | 6               | 7               |
| Balance as of September 30, 2008                                | \$ 47,971    | \$ 15,866       | \$ 32,105       |

Intangible assets are summarized as follows:

### Acquired Intangible Assets

|                                      | As of September 30, 2008 |                                      |                          |
|--------------------------------------|--------------------------|--------------------------------------|--------------------------|
|                                      | Gross Carrying Amount    | Weighted Average Amortization Period | Accumulated Amortization |
| <b>Amortizing intangible assets:</b> |                          |                                      |                          |
| Technology                           | \$ 4,910                 | 4.0 years                            | \$ 1,228                 |
| Customer contracts/customer lists    | 2,400                    | 3.0 years                            | 1,761                    |
| Trade names                          | 630                      | 3.0 years                            | 210                      |
| Other                                | 235                      | 3.0 years                            | 78                       |
| Total                                | \$ 8,175                 |                                      | \$ 3,277                 |

Amortization expense is calculated on a straight-line basis over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was \$2,055 and \$1,772 for the nine months ended September 30, 2008 and the year ended December 31, 2007, respectively. Estimated amortization expense for the next five years is: \$579 in 2008, \$1,955 in 2009, \$1,444 in 2010, \$920 in 2011 and \$0 in 2012.

### (H) RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In April 2008, the FASB issued FSP 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets." FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of FSP 142-3 on its consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133" ("SFAS No. 161"). This Standard requires enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities"; and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. The Standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. As SFAS No. 161 relates specifically to disclosures, the Standard will have no impact on the Company's consolidated financial statements.

In December 2007, the FASB issued Statement No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) established principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired. SFAS No. 141(R) also established disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that SFAS No. 141(R) will have on its accounting for past and future acquisitions and on its consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 allows entities the option to measure at fair value eligible financial instruments that are not currently measured at fair value. SFAS No. 159 is effective for financial statements issued for

fiscal years beginning after November 15, 2007. Although the Company has adopted this standard, the Company has not yet elected the fair value option for any assets or liabilities, and therefore the adoption of this standard has not had any impact on its financial position or results of operations.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with the exception of all non-financial assets and liabilities which will be effective for years beginning after November 15, 2008. The Company adopted the required provisions of SFAS No. 157 that became effective in its first quarter of 2008. The adoption of these provisions did not have a material impact on Company's consolidated financial statements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for certain items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company is currently evaluating the impact of SFAS No. 157 on its Consolidated Financial Statements for items within the scope of FSP 157-2, which will become effective beginning with the Company's first quarter of 2009.

**(2) BALANCE SHEET COMPONENTS**

Property and equipment is summarized as follows:

|  | <b>September 30, 2008</b> |              | <b>December 31, 2007</b> |              |
|--|---------------------------|--------------|--------------------------|--------------|
| Computer equipment and software                | \$                        | 10,970       | \$                       | 6,033        |
| Furniture, equipment and building improvements |                           | 681          |                          | 565          |
|  |                           | 11,651       |                          | 6,598        |
| Less accumulated depreciation                  |                           | 4,189        |                          | 2,865        |
| <b>Total</b>                                   | <b>\$</b>                 | <b>7,462</b> | <b>\$</b>                | <b>3,733</b> |

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Accrued expenses consist of the following:

|  | <b>September 30, 2008</b> |       | <b>December 31, 2007</b> |       |
|--|---------------------------|-------|--------------------------|-------|
| Payroll and other employee related costs                   | \$                        | 5,315 | \$                       | 4,790 |
| Professional services and consulting and other vendor fees |                           | 2,178 |                          | 3,856 |
| Sales commissions  |                           | 313   |                          | 286   |
| Restructuring (see Note 3)                                 |                           | -     |                          | 49    |
| Other  |                           | 560   |                          | 210   |
| Total  | \$                        | 8,366 | \$                       | 9,191 |

### **(3) ASSET 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 purchase price was \$10,445, which included the issuance of 1,960,711 shares of the Company’s common stock valued at \$9,929, based on the quoted market price of the Company’s common stock for the three days before and after the date of the announcement, a cash payment of \$3 and acquisition costs of approximately \$513. The acquisition added several U.K. based financial services clients and provided an innovative product marketing team. All 1,960,711 shares are included in the weighted average shares outstanding used in basic and diluted net income per common share as of the acquisition date. Of the total purchase price, \$413 was allocated to the net book values of the acquired assets and assumed liabilities. The historical carrying amounts of such assets and liabilities approximated their fair values. The purchase price in excess of the fair value of the net book values of the acquired assets and assumed liabilities was allocated to goodwill and intangible assets. None of the goodwill will be deductible for U.S. federal income tax purposes. The intangible assets are being amortized over their expected period of benefit. During the twelve months ended December 31, 2007, the Company reduced accrued severance costs in the amount of \$122 and reduced accrued restructuring costs related to contract terminations in the net amount of \$7. The Company incurred additional costs in the amount of \$286, resulting in a net increase in goodwill of approximately \$157 in the twelve months ended December 31, 2007. The Company incurred additional costs in the amount of \$153 and reduced the valuation reserve on acquired net operating losses in the amount of \$3,031, resulting in a net decrease in goodwill in the amount of \$2,878 in the nine months ended September 30, 2008.

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 \$21 related to this contingency. At March 31, 2007, the value of these shares has been allocated to goodwill with a corresponding increase in equity. All 1,127,985 shares are included in the weighted average shares outstanding used in basic and diluted net income per common share as of March 31, 2007. In accordance with the purchase agreement, the earn-out consideration is 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. The complaint filed by the Shareholders’ Representative seeks certain documentation relating to calculation of the earn-out consideration, and seeks payment of substantially all of the remaining contingently issuable earn-out shares. The Company believes the claims are without merit, intends to vigorously defend against this lawsuit, and does not currently expect that the total shares issued will differ significantly from the amount issued to date.

The Company initiated a restructuring plan to eliminate redundant facilities, personnel and service providers in connection with the Proficient acquisition. These costs were recognized as liabilities in connection with the acquisition and have been recorded as an increase in goodwill as of the acquisition date.

The balance of the accrued restructuring liability as of September 30, 2008 is as follows:

|                       | Balance as of   |                    | Provision for the |                    | Net utilization |                    | Balance as of      |                    |
|-----------------------|-----------------|--------------------|-------------------|--------------------|-----------------|--------------------|--------------------|--------------------|
|                       | January 1, 2008 |                    | nine months ended |                    | during the nine |                    | September 30, 2008 |                    |
|                       |                 | September 30, 2008 |                   | September 30, 2008 |                 | September 30, 2008 |                    | September 30, 2008 |
| Contract terminations | \$              | 49                 | \$                | —                  | \$              | (49)               | \$                 | -                  |
| Total                 | \$              | 49                 | \$                | —                  | \$              | (49)               | \$                 | -                  |

#### *Kasamba Inc.*

On October 3, 2007, the Company acquired Kasamba Inc. (“Kasamba”), an online provider of live expert advice delivered to consumers via real-time chat. This transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of Kasamba were included in the Company’s consolidated results of operations from October 3, 2007.

The purchase price was \$35,880, which included the issuance of 4,130,776 shares of the Company’s stock valued at \$23,925, based on the quoted market price of the Company’s common stock for the two days before and after the date of the announcement, the issuance of 623,824 LivePerson options in replacement of Kasamba options, some of which were fully vested, valued at \$1,965, a cash payment of \$9,000 and acquisition costs of approximately \$990. The Company recorded goodwill in the amount of \$32,940, none of which will be deductible for U.S. federal income tax purposes. The acquisition represents the Company’s initial expansion beyond its historical business-to-business focus into the business-to-consumer market, and is also expected to extend the value the Company delivers to its growing base of business customers through a community that will connect consumers with experts in a range of categories. All 4,130,776 shares are included in the weighted average shares outstanding used in basic and diluted net income per common share as of October 3, 2007. Of the total purchase price, a net liability of \$812 was allocated to the net book values of the acquired assets and assumed liabilities. The historical carrying amounts of such assets and liabilities approximated their fair values. The purchase price in excess of the fair value of the net book values of the acquired assets and assumed liabilities was allocated to goodwill and intangible assets which are being amortized over their expected period of benefit. The Company incurred additional costs in the amount of \$7 and reduced the valuation reserve on acquired net operating losses in the amount of \$842, resulting in a net decrease in goodwill in the amount of \$835 in the nine months ended September 30, 2008.

#### **(4) 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 nine months ended September 30, 2008 was approximately \$682 and \$1,878, respectively. Rental expense for operating leases for the three and nine months ended September 30, 2007 was approximately \$390 and \$1,165, respectively.



**(5) 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 in the second quarter of 2007 to the shareholders of Proficient. The complaint filed by the Shareholders' Representative seeks certain documentation relating to calculation of the earn-out consideration, and seeks payment of substantially all of the remaining contingently issuable earn-out shares. The Company believes the claims are without merit, intends to vigorously defend against this lawsuit, and does not currently expect that the total shares issued will differ significantly from the amount issued to date.

On January 29, 2008, the Company filed a complaint in the United States District Court for the District of Delaware against NextCard, LLC and Marshall Credit Strategies, LLC, seeking a declaratory judgment that a patent purportedly owned by the defendants is invalid and not infringed by the Company's products. On March 18, 2008, the Company amended its complaint to add a second patent to the case. Monetary relief is not sought. On April 30, 2008, NextCard, LLC filed a complaint in the United States District Court for the Eastern District of Texas, asserting infringement of these same two patents by the Company, and seeking monetary damages and an injunction. The Company believes the claims are without merit, and intends to vigorously defend against this lawsuit. The Company is presently unable to estimate the likely costs of the litigation of these legal proceedings. The Company expects its operations to continue without interruption during the period of litigation.

The Company is not currently party to any other legal proceedings. From time to time, the Company may be subject to various claims and legal actions arising in the ordinary course of business.

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

### **OVERVIEW**

LivePerson provides online engagement solutions that facilitate real-time assistance and trusted expert advice. Our hosted software platform creates more relevant, compelling and personalized online experiences.

We were incorporated in the State of Delaware in November 1995 and the LivePerson service was introduced initially in November 1998.

On July 18, 2006, we acquired Proficient Systems, Inc. ("Proficient"), a provider of hosted proactive chat solutions that help companies generate revenue on their websites. The acquisition added several U.K. based financial services clients and provided an innovative product marketing team. Under the terms of the agreement, we acquired all of the outstanding capital stock of Proficient in exchange for 2.0 million shares of our common stock, valued at \$9.9 million, paid at closing, and up to an additional 2.05 million shares based on the achievement of certain revenue targets as of March 31, 2007. Based on these targets, we issued approximately 1.1 million additional shares valued at \$8.9 million. At March 31, 2007, the value of these shares has been allocated to goodwill and we have included these shares in the weighted average shares outstanding used in basic and diluted net income per share. The net intangibles of \$0.6 and \$1.3 million are included in "Assets - Intangibles, net" on our September 30, 2008 and December 31, 2007 balance sheets, respectively.

On October 3, 2007, we acquired Kasamba Inc. ("Kasamba"), a facilitator of online transactions between service experts who provide online advice to consumers for total consideration of approximately \$35.9 million. The acquisition accelerated our expansion into the business-to-consumer market, and is expected to extend the value we deliver to our growing base of business customers through a community that will connect consumers with experts in a range of categories. Under the terms of the agreement, we acquired all of the outstanding capital stock of Kasamba in exchange for 4,130,776 shares of our common stock, \$9.0 million in cash and the assumption of 623,824 Kasamba options. The net intangibles of \$4.3 and \$5.6 million are included in "Assets - Intangibles, net" on our September 30, 2008 and December 31, 2007 balance sheets, respectively.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

#### ***GENERAL***

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed 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 collectibility of 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.

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***

LivePerson provides online engagement solutions that facilitate real-time assistance and expert advice. Our hosted software platform creates more relevant, compelling and personalized online experiences.

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Our primary revenue source is from the sale of the LivePerson services under the brand names Timpani and LivePerson. With the acquisition of Kasamba on October 3, 2007, we also facilitate online transactions between experts who provide online advice to consumers.

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 SEC Staff Accounting Bulletin No. 104, "Revenue Recognition" and Emerging Issues Task Force Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." 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. 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 upon 30 to 90 days' notice without penalty. When professional service fees provide added value to the customer on a standalone basis and there is objective and reliable evidence of the fair value of each deliverable, we recognize professional service fees upon completion and customer acceptance of key milestones within each of the professional services engagements. 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 36 months, representing our current estimate of the term of the client relationship.

For revenue generated from online transactions between experts and consumers, we apply Emerging Issues Task Force ("EITF") 99-19, "Reporting Revenue Gross as a Principle versus Net as an Agent" 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 adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year. Our Consolidated Financial Statements as of and for the three months ended September 30, 2008 and 2007 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, our Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

As of September 30, 2008, there was approximately \$10.5 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 2.3 years.

### ***ACCOUNTS RECEIVABLE***

Our customers are primarily concentrated 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. Our concentration of credit risk is limited due to the large number of customers. No single customer accounted for or exceeded 10% of our total revenue in the three and nine months ended September 30, 2008 and 2007. One customer accounted for approximately 16% of accounts receivable as September 30, 2008. No single customer accounted for or exceeded 10% of accounts receivable at December 31, 2007. We increased our allowance for doubtful accounts by \$68,000 in the nine months ended September 30, 2008, principally due to an increase in accounts receivable as a result of increased sales and to the fact that a larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. Additionally, we wrote off approximately \$16,000 of previously reserved accounts, leaving a net allowance of \$260,000 at September 30, 2008.

## ***GOODWILL***

In accordance with SFAS No. 142, "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 obtain appraisals from an independent valuation firm. In addition to the use of an independent valuation firm, we 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.

In accordance with SFAS No. 142, we completed our annual impairment test in the third quarter of 2008. Based on this test, we determined that no impairment had occurred. Beginning in the first quarter of 2009, we are required to adopt the provisions of SFAS No. 157. We are currently evaluating the impact of SFAS No. 157 on goodwill. We may be required to record a significant charge to earnings in our financial statements if we determine that an impairment has occurred under the new pronouncement.

## ***IMPAIRMENT OF LONG-LIVED ASSETS***

In accordance with SFAS No. 144, "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 PRONOUNCEMENTS***

In April 2008, the FASB issued FSP 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets." FSP 142-3 is effective for fiscal years beginning after December 15, 2008. We are currently assessing the impact of FSP 142-3 on our consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133" (SFAS No. 161). This Standard requires enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities"; and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. The Standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. As SFAS No. 161 relates specifically to disclosures, the Standard will have no impact on our consolidated financial statements.

In December 2007, the FASB issued Statement No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) established principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired. SFAS No. 141(R) also established disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact that SFAS No. 141(R) will have on our accounting for past and future acquisitions and on our consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 allows entities the option to measure at fair value eligible financial instruments that are not currently measured at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Although we have adopted this standard, we have not yet elected the fair value option for any assets or liabilities, and therefore the adoption of this standard has not had any impact on our financial position or results of operations.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with the exception of all non-financial assets and liabilities which will be effective for years beginning after November 15, 2008. The Company adopted the required provisions of SFAS No. 157 that became effective in our first quarter of 2008. The adoption of these provisions did not have a material impact on Company's consolidated financial statements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for certain items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We are currently evaluating the impact of SFAS No. 157 on our Consolidated Financial Statements for items within the scope of FSP 157-2, which will become effective beginning with our first quarter of 2009.

### **RESULTS OF OPERATIONS**



***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. The proportion of our new clients that are large corporations is increasing. These companies typically have more significant implementation requirements and more stringent data security standards. As a result, our professional services revenue has begun to increase. Such clients also have more sophisticated data analysis and performance reporting requirements, and are more likely to engage our professional services organization to provide such analysis and reporting on a recurring basis. As a result, it is likely that a greater proportion of our future revenue will be generated from such ongoing professional services work.

Revenue attributable to our monthly service fee accounted for 94% of total LivePerson services revenue for the three and nine months ended September 30, 2008. Revenue attributable to our monthly service fee accounted for 97% and 95% of total LivePerson services revenue for the three and nine months ended September 30, 2007, respectively. Our service agreements typically have twelve month terms and are terminable 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.

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.

With the acquisition of Kasamba on October 3, 2007, we also facilitate online transactions between experts who provide online advice to consumers. We collect a fee from the user and retain a portion of the fee, and then remit the balance to the expert.

We also have entered into contractual arrangements that complement our direct sales force and online sales efforts. These are primarily with Web hosting and 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;
- allocated occupancy costs and related overhead;
- the cost of supporting our infrastructure, including expenses related to server leases, infrastructure support costs and Internet connectivity, as well as depreciation of certain hardware and software; and
- the credit card fees and related processing costs associated with the consumer and SMB services.

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, insurance, provision for doubtful accounts and other general corporate expenses.



During the nine months ended September 30, 2008, we increased our allowance for doubtful accounts by \$68,000, principally due to an increase in accounts receivable as a result of increased sales and to the fact that a larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. Additionally, wrote off approximately \$16,000 of previously reserved accounts leaving a net allowance of \$260,000 at September 30, 2008. During 2007, we increased our allowance for doubtful accounts by \$103,000 to approximately \$208,000, principally due to an increase in accounts receivable as a result of increased sales. 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 nine months ended September 30, 2008 and 2007 consist of:

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2008                                | 2007   | 2008                               | 2007     |
| Stock-based compensation expense related to SFAS No. 123(R) | \$ 1,014                            | \$ 930 | \$ 3,178                           | \$ 2,642 |
| Total   | \$ 1,014                            | \$ 930 | \$ 3,178                           | \$ 2,642 |

### ***PERIOD-TO-PERIOD COMPARISONS***

Due to our acquisition of Kasamba in October 2007, Proficient in July 2006, and our limited operating history, we believe that three and nine months ended September 30, 2008 and 2007 with each other, or with those of prior periods, are not meaningful and that our historical operating results should not be relied upon as indicative of future performance.

#### ***Comparison of Three and Nine Months Ended September 30, 2008 and 2007***

**Revenue.** Total revenue increased by 51% and 55% to \$19.4 million and \$55.0 million in the three and nine months ended September 30, 2008, respectively, from \$12.8 million and \$35.5 million in the comparable periods in 2007. Excluding Kasamba revenue in the amounts of \$2.6 million and \$8.1 million, revenue increased by 30% and 32% to \$16.7 million and \$46.9 million in the three and nine months ended September 30, 2008, respectively, from the comparable periods in 2007. This increase is primarily attributable to increased revenue from existing clients in the amount of approximately \$2.2 million and \$7.1 million, respectively, and, to a lesser extent, to revenue from new clients in the amount of approximately \$2.0 million and \$5.7 million, respectively, net of cancellations and an increase in professional services revenue of approximately \$203,000 and \$855,000, respectively. Our revenue growth has traditionally been driven by both newly added clients and expansion of existing clients.

**Cost of Revenue.** 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 hosting infrastructure, including expenses related to server leases and Internet connectivity, as well as depreciation of certain hardware and software, and allocated occupancy costs and related overhead. Cost of revenue increased by 58% and 67% to \$5.2 million and \$15.3 million in the three and nine months ended September 30, 2008, respectively, from \$3.3 million and \$9.2 million in the comparable period in 2007. Excluding Kasamba cost of revenue in the amounts of \$651,000 and \$1.9 million, cost of revenue increased by 38% and 46% to \$4.6 million and \$13.4 million in the three and nine months ended September 30, 2008, respectively, from the comparable periods in 2007. This increase is primarily attributable to costs related to additional account management and network operations personnel to support increased client activity from existing clients and the addition of new clients in the amount of approximately \$912,000

and \$2.4 million, respectively. The increase is also attributable to technology amortization related to our Kasamba acquisition in the amount of \$251,000 and \$698,000 and to the depreciation recorded relating to the colocation hosting equipment in the amounts of \$275,000 and \$475,000 in the three and nine months ended September 30, 2008, respectively. As a result, our gross margin in the three and nine months ended September 30, 2008 decreased to 73% and 72%, respectively, as compared to 74% in the three and nine months ended September 30, 2007, respectively. The proportion of our new clients that are large corporations is increasing. These companies typically have more significant implementation requirements and more stringent data security standards. As a result, we have invested additional resources to support this change in the customer base and in anticipation of a continuation of this trend, which has increased our cost of revenue and decreased our gross margin. We recently completed the transition of our primary U.S. hosting facility from fully hosted services to a colocation arrangement. The expected impact of this transition is a reduction in operating expense related to third-party hosting services, partially offset by an increase in depreciation expense related to capital expenditures for servers and related network equipment. This transition is expected to give us more direct control and greater deployment flexibility with regard to our hosting infrastructure.

**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 52% and 64% to \$3.3 million and \$9.9 million in the three and nine months ended September 30, 2008, respectively, from \$2.2 million and \$6.0 million in the comparable periods in 2007. Excluding Kasamba product development expenses in the amounts of \$789,000 and \$2.3 million, product development expenses increased by 16% and 26% to \$2.5 million and \$7.6 million in the three and nine months ended September 30, 2008, respectively, from the comparable periods in 2007. This increase is primarily attributable to costs related to additional product development personnel to support the continuing development of our product line as we broaden the range of services we offer to include a fully integrated, multi-channel software platform in the amount of \$606,000 and \$1.7 million, respectively.

**Sales and Marketing.** Our sales and marketing expenses consist of compensation and related expenses for sales and marketing personnel, as well as advertising, public relations and trade show exhibit expenses. Sales and marketing expenses increased by 86% and 80% to \$6.6 million and \$18.9 million in the three and nine months ended September 30, 2008, respectively from \$3.6 million and \$10.5 million in the comparable periods in 2007. Excluding Kasamba sales and marketing expenses in the amounts of \$2.1 million and \$5.5 million, sales and marketing expenses increased by 29% and 28% to \$4.6 million and \$13.4 million in the three and nine months ended September 30, 2008, respectively, from the comparable periods in 2007. This increase is primarily attributable to an increase in costs related to additional sales and marketing personnel of approximately \$1.1 million and \$2.7 million related to our continued efforts to enhance our brand recognition and increase sales lead activity.

**General and Administrative.** Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, human resources and administrative personnel. General and administrative expenses increased by 49% and 58% to \$3.4 million and \$10.0 million in the three and nine months ended September 30, 2008, respectively from \$2.3 million and \$6.4 million in the comparable periods in 2007. Excluding Kasamba general and administrative expenses in the amount of \$243,000 and \$827,000, general and administrative expenses increased by 39% and 45% to \$3.2 million and \$9.2 million in the three and nine months ended September 30, 2008, respectively, from the comparable periods in 2007. This increase is primarily attributable to increases in compensation and related expenses in the amount of \$436,000 and \$1.3 million, respectively, and to an increase in professional services and recruiting in the amount of \$241,000 and \$893,000, respectively. This increase is also attributable to increases in rent and occupancy costs related to an expansion of our Israeli offices in the amount of approximately \$297,000 and \$707,000, respectively.

**Amortization of Intangibles.** Amortization expense was \$352,000 and \$1.1 million in the three and nine months ended September 30, 2008, compared to \$242,000 and \$725,000 in the comparable periods in 2007, respectively. Amortization expense in 2008 relates primarily to acquisition costs recorded as a result of our acquisition of Kasamba in October 2007. Amortization expense in 2007 relates to acquisition costs recorded as a result of our acquisition of certain identifiable assets of Proficient in July 2006.

**Other (Expense) Income.** Financial expense related to unfavorable currency movements was \$123,000 and \$125,000 in the three and nine months ended September 30, 2008 compared to financial income from favorable currency movements of \$26,000 and \$5,000 in the comparable periods in 2007, respectively. Interest income was \$79,000 and \$270,000 in the three and nine months ended September 30, 2008, compared to \$283,000 and \$739,000 in the comparable periods in 2007, respectively, and consists of interest earned on cash and cash equivalents generated by the receipt of proceeds from our initial public offering in 2000 and preferred stock issuances in 2000 and 1999 and, to a lesser extent, cash provided by operating activities. These decreases are primarily attributable to decreases in short-term interest rates and smaller balances in interest bearing accounts as a result of our acquisition of Kasamba in October 2007.



**Provision for (Benefit from) Income Taxes.** Income tax expense was \$21,000 in the three months ended September 30, 2008. Benefit from income taxes was \$68,000 in the nine months ended September 30, 2008. Income tax expense was \$0 and \$0 in the three and nine months ended September 30, 2007 because we reduced our valuation allowance against deferred tax assets resulting in an effective tax rate of zero.

**Net Income.** We had net income of \$410,000 and \$7,000 in the three and nine months ended September 30, 2008, compared to net income of \$1.6 million and \$3.4 million for the comparable periods in 2007. Revenue increased by \$6.6 million and \$19.6 million, respectively, while operating expenses increased by \$7.4 million and \$22.5 million, respectively, contributing to a net decrease in income from operations of approximately \$802,000 and \$2.9 million, respectively, along with a decrease in other income of \$353,000 and \$599,000, respectively.

## LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2008, we had approximately \$23.8 million in cash and cash equivalents, a decrease of approximately \$2.5 million from December 31, 2007. This decrease is primarily attributable to the purchases of property and equipment and, to a lesser extent, to the repurchase of common stock. We regularly invest excess funds in short-term money market funds that provide daily access to the full liquidity of the amount on deposit.

Net cash provided by operating activities was \$6.3 million for the nine months ended September 30, 2008 and consisted primarily of non-cash expenses related to the adoption of SFAS No. 123(R), to the amortization of intangibles, and to increases in accounts payable and deferred revenue, partially offset by an increase in accounts receivable, a decrease in accrued expenses, and an increase in prepaid expenses. Net cash provided by operating activities was \$4.6 million for the nine months ended September 30, 2007 and consisted primarily of net income and non-cash expenses related to the adoption of SFAS No. 123(R) and to the amortization of intangibles and an increase in accrued expenses, partially offset by increases in deferred taxes and, accounts receivable.

Net cash used in investing activities was \$5.6 million and \$1.0 million in the nine months ended September 30, 2008 and 2007, respectively, and was due primarily to the purchase of fixed assets and, to a lesser extent, to the payment of acquisition costs.

Net cash used in financing activities was \$3.0 million for the nine months ended September 30, 2008 and consisted primarily of the repurchase of common stock partially offset by the proceeds from the issuance of common stock in connection with the exercise of stock options by employees. Net cash provided by financing activities was \$4.8 million for the nine months ended September 30, 2007 and consisted of the excess tax benefit from the exercise of employee stock options and proceeds from the issuance of common stock in connection with the exercise of stock options by employees.

We have incurred significant costs 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 September 30, 2008, we had an accumulated deficit of approximately \$93.4 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 nine months ended September 30, 2008 was approximately \$682,000 and \$1.9 million, respectively, and approximately \$390,000 and \$1.2 million for the three and nine months ended September 30, 2007.

As of September 30, 2008, our principal commitments were approximately \$8.0 million under various operating leases, of which approximately \$1.0 million is due in 2008. We do not currently expect that our principal commitments for the year ending December 31, 2008 will exceed \$4.0 million in the aggregate. Our capital expenditures are not currently expected to exceed \$8.0 million in 2008.

Our contractual obligations at September 30, 2008 are summarized as follows:

| <b>Contractual Obligations</b> | <b>Payments due by period</b> |                             |                  |                  |                              |
|--------------------------------|-------------------------------|-----------------------------|------------------|------------------|------------------------------|
|                                | <b>(in thousands)</b>         |                             |                  |                  |                              |
|                                | <b>Total</b>                  | <b>Less than 1<br/>year</b> | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than 5<br/>years</b> |
| Operating leases               | \$ 8,018                      | \$ 3,879                    | \$ 4,066         | \$ 73            | \$ —                         |
| Total                          | \$ 8,018                      | \$ 3,879                    | \$ 4,066         | \$ 73            | \$ —                         |

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

#### *Currency Rate Fluctuations*

As a result of the expanding 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 nine months ended September 30, 2008, the depreciation of the U.S. dollar against the NIS has had an increased adverse impact on our results of operations and financial condition compared to earlier periods. We evaluate appropriate hedging strategies to mitigate currency rate fluctuation risks on an ongoing basis. The functional currency of our wholly-owned Israeli subsidiaries, 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. We have not used derivative financial instruments to limit our foreign currency risk exposure.

#### *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. We increased our allowance for doubtful accounts in the nine months ended September 30, 2008 by \$68,000 principally due to an increase in accounts receivable as a result of increased sales and to the fact that a larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. Additionally, we wrote off approximately \$16,000 of previously reserved accounts, leaving a net allowance of \$260,000 at September 30, 2008. During 2007, we increased our allowance for doubtful accounts by \$103,000 to approximately \$208,000, principally due to an increase in accounts receivable as a result of increased sales. We wrote off approximately \$6,000 of previously reserved accounts during the nine months ended September 30, 2008. We did not write off any accounts during the year ended December 31, 2007.

#### *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.

### 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 September 30, 2008. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2008 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 September 30, 2008 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 except that we have integrated the Kasamba operations and have begun to incorporate these operations as part of our internal controls. We expect our assessment of these changes in internal control to be completed in 2008.

*Limitations of the Effectiveness of Internal Control*

A control system, no matter how well conceived and operated, can provide only 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, within a company 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 in the second quarter of 2007 to the shareholders of Proficient. The complaint filed by the Shareholders' Representative seeks certain documentation relating to calculation of the earn-out consideration, and seeks payment of substantially all of the remaining contingently issuable earn-out shares. We believe the claims are without merit, intend to vigorously defend against this lawsuit, and do not currently expect that the total shares issued will differ significantly from the amount issued to date.

On January 29, 2008, we filed a complaint in the United States District Court for the District of Delaware against NextCard, LLC and Marshall Credit Strategies, LLC, seeking a declaratory judgment that a patent purportedly owned by the defendants is invalid and not infringed by our products. On March 18, 2008, we amended our complaint to add a second patent to the case. Monetary relief is not sought. On April 30, 2008, NextCard, LLC filed a complaint in the United States District Court for the Eastern District of Texas, asserting infringement of these same two patents by us, and seeking monetary damages and an injunction. We believe the claims are without merit, and intend to vigorously defend against this lawsuit. We are presently unable to estimate the likely costs of the litigation of these legal proceedings. We expect our operations to continue without interruption during the period of litigation.

We are not currently party to any other legal proceedings. From time to time, we may be subject to various claims and legal actions arising in the ordinary course of business.

### **ITEM 1A. RISK FACTORS**

Risks that could have a material and adverse impact on our business, results of operations and financial condition include, without limitation, the following: risks related to the operational integration of acquisitions; risks related to our increased operations in the direct-to-consumer market; risks related to our international operations, particularly our operations in Israel, and the civil and political unrest in that region; volatility of the value of certain currencies in relation to the U.S. dollar, particularly the New Israeli Shekel, U.K. pound and Euro; our history of losses; potential fluctuations in our quarterly and annual results; impairments to goodwill that result in significant charges to earnings; responding to rapid technological change and changing client preferences; competition in the real-time sales, marketing, customer service and online engagement solutions market; continued use by our clients of the LivePerson services and their purchase of additional services; technology systems beyond our control and technology-related defects that could disrupt the LivePerson services; risks related to adverse business conditions experienced by our clients; our dependence on key employees; competition for qualified personnel; the impact of new accounting rules, including the requirement to expense stock options; the possible unavailability of financing as and if needed; risks related to protecting our intellectual property rights or potential infringement of the intellectual property rights of third parties; our dependence on the continued use of the Internet as a medium for commerce and the viability of the infrastructure of the Internet; and risks related to the regulation or possible misappropriation of personal information. This list is intended to identify only certain of the principal factors that could cause actual results to differ from those discussed in the forward-looking statements. Readers are referred to the reports and documents filed from time to time by us with the Securities and Exchange Commission for a discussion of these and other important risk factors that could cause actual results to differ from those discussed in forward-looking statements. 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 14, 2008.

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

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**ITEM 2. PURCHASES OF EQUITY SECURITIES BY THE ISSUER**

On March 10, 2008, our Board of Directors approved an extension of our existing stock repurchase program through the end of the first quarter of 2009. The program, originally announced in February 2007, was due to expire at the end of the first quarter of 2008.

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 \$8.0 million. Through September 30, 2008, we had spent a total of approximately \$3.6 million to acquire approximately 1.1 million shares of our common stock. Our Board of Directors may discontinue the program at any time.

The following table summarizes repurchases of our common stock under our stock repurchase program during the quarter ended September 30, 2008:

| <b>Period</b>        | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b> | <b>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs</b> |
|----------------------|---|-------------------------------------|---|---|
| 7/1/2008 – 7/31/2008 | —\$                                     | —                                   | —\$   | 4,363,000   |
| 8/1/2008 – 8/31/2008 | —\$                                     | —                                   | —\$   | 4,363,000   |
| 9/1/2008 – 9/30/2008 | —\$                                     | —                                   | —\$   | 4,363,000   |
| <b>Total</b>         | <b>—\$</b>                              | <b>—</b>                            | <b>—\$</b>  | <b>4,363,000</b>  |

**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: November 7, 2008

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

Date: November 7, 2008

By: /s/ TIMOTHY E. BIXBY  
Name: Timothy E. Bixby  
Title: President and Chief Financial Officer (principal financial and accounting officer)

EXHIBIT INDEX

EXHIBIT

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

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