LIVEPERSON INC
Form 10-Q
May 11, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________________ to ____________________
Commission file number: 000-30141
LIVEPERSON, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	13-3861628
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
475 Tenth Avenue, 5th Floor New York, New York	10018
(Address of Principal Executive Offices)	(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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one).

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
On May 5, 2015, 57,051,150 shares of the registrant's common stock were outstanding.

1

LIVEPERSON, INC.
March 31, 2015
FORM 10-Q
INDEX

		PAGE
Part I.	Financial Information	4
Item 1.	Financial Statements	4
	Unaudited Condensed Consolidated Balance Sheets as of March 31, 2015 and December 31, 2014	4
	Unaudited Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2015 and 2014	5
	Unaudited Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended March 31, 2015 and 2014	6
	Unaudited Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2015 and 2014	7
	Notes to Condensed Consolidated Financial Statements (Unaudited)	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	32
Item 4.	Controls and Procedures	32
Part II.	Other Information	33
Item 1.	Legal Proceedings	33
Item 1A.	Risk Factors	33
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	34
Item 3.	Defaults Upon Senior Securities	34
Item 4.	Mine Safety Disclosures	34
Item 5.	Other Information	34
Item 6.	Exhibits	35
Signatures		37

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 PROGRESSES, AND THEREFORE IT SHOULD BE CLEARLY UNDERSTOOD THAT THE INTERNAL PROJECTIONS AND BELIEFS UPON WHICH WE BASE OUR EXPECTATIONS MAY CHANGE PRIOR TO THE END OF EACH QUARTER OR THE YEAR. ALTHOUGH THESE EXPECTATIONS MAY CHANGE, WE ARE UNDER NO OBLIGATION TO INFORM YOU IF THEY DO. OUR COMPANY POLICY IS GENERALLY TO PROVIDE OUR EXPECTATIONS ONLY ONCE PER QUARTER, AND NOT TO UPDATE THAT INFORMATION UNTIL THE NEXT QUARTER. ACTUAL EVENTS OR RESULTS MAY DIFFER MATERIALLY FROM THOSE CONTAINED IN THE PROJECTIONS OR FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE THOSE DISCUSSED IN PART II, ITEM 1A, “RISK FACTORS.”

Part I. Financial Information
Item 1. Financial Statements
LIVEPERSON, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)
(UNAUDITED)

	March 31, 2015	December 31, 2014 (Note 1)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$40,836	$49,372
Accounts receivable, net of allowance for doubtful accounts of $1,360 and $1,275 as of March 31, 2015 and December 31, 2014, respectively	35,588	31,382
Prepaid expenses and other current assets	12,919	10,374
Deferred tax assets, net	1,236	2,575
Total current assets	90,579	93,703
Property and equipment, net	20,973	19,583
Intangibles, net	30,629	32,620
Goodwill	80,310	80,848
Deferred tax assets, net	11,281	10,762
Other assets	2,316	2,301
Total assets	$236,088	$239,817
LIABILITIES AND STOCKHOLDERS’ EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$12,568	$8,985
Accrued expenses and other current liabilities	31,531	37,772
Deferred revenue	10,216	11,992
Total current liabilities	54,315	58,749
Other liabilities	724	731
Total liabilities	55,039	59,480
Commitments and contingencies (See Note 10)		
STOCKHOLDERS’ EQUITY (See Note 11):		
Common stock	58	57
Additional paid-in capital	277,801	274,046
Treasury stock	(1)	(1)
Accumulated deficit	(94,682)	(92,627)
Accumulated other comprehensive loss	(2,127)	(1,138)
Total stockholders’ equity	181,049	180,337
Total liabilities and stockholders’ equity	$236,088	$239,817

See Notes to Condensed Consolidated Financial Statements (unaudited).

LIVEPERSON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(UNAUDITED)

	Three Months Ended March 31,	
	2015	2014
Revenue	$59,770	$47,828
Costs and expenses [1] [2]		
Cost of revenue [3]	16,254	11,735
Sales and marketing	24,294	18,395
General and administrative	10,164	9,499
Product development	9,800	8,951
Amortization of purchased intangibles	1,313	190
Total costs and expenses	61,825	48,770
Loss from operations	(2,055)	(942)
Other expense	(231)	(83)
Loss before benefit from income taxes	(2,286)	(1,025)
Benefit from income taxes	(228)	(231)
Net loss	$(2,058)	$(794)
Net loss per share of common stock:		
Basic	$(0.04)	$(0.01)
Diluted	$(0.04)	$(0.01)
Weighted-average shares used to compute net loss per share:		
Basic	56,291,383	54,666,535
Diluted	56,291,383	54,666,535

[1] Amounts include stock compensation expense, as follows:		
Cost of revenue	$328	$360
Sales and marketing	595	814
General and administrative	932	843
Product development	939	680
[2] Amounts include depreciation expense, as follows:		
Cost of revenue	$1,903	$1,397
Sales and marketing	250	207
General and administrative	237	200
Product development	188	177
[3] Amounts include amortization of purchased intangibles, as follows:		
Cost of revenue	$839	$868

See Notes to Condensed Consolidated Financial Statements (unaudited).

LIVEPERSON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(IN THOUSANDS)
(UNAUDITED)

	Three Months Ended March 31,	
	2015	2014
Net loss	$(2,058)	$(794)
Foreign currency translation adjustment	(989)	140
Comprehensive loss	$(3,047)	$(654)

See Notes to Condensed Consolidated Financial Statements (unaudited).

6

LIVEPERSON, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Three Months Ended March 31,	
	2015	2014
OPERATING ACTIVITIES:		
Net loss	$(2,058)	$(794)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	2,794	2,697
Depreciation	2,578	1,981
Amortization of purchased intangibles	2,152	1,058
Deferred income taxes and other non-cash tax items	820	(76)
Provision for doubtful accounts, net	403	271
Changes in operating assets and liabilities:		
Accounts receivable	(4,609)	48
Prepaid expenses and other current assets	(2,544)	(3,930)
Other assets	(15)	460
Accounts payable	1,359	1,114
Accrued expenses and other current liabilities	(7,045)	(3,828)
Deferred revenue	(1,776)	(1,586)
Other liabilities	361	(414)
Net cash used in operating activities	(7,580)	(2,999)
INVESTING ACTIVITIES:		
Purchases of property and equipment, including capitalized software	(1,783)	(1,456)
Investment in technology licenses	—	(3,174)
Payments for acquisitions and intangible assets, net of cash acquired	—	(125)
Net cash used in investing activities	(1,783)	(4,755)
FINANCING ACTIVITIES:		
Excess tax benefit from the exercise of employee stock options	751	—
Proceeds from issuance of common stock in connection with the exercise of options	2,284	2,978
Repurchase of common stock	(2,058)	(7,841)
Net cash provided by (used in) financing activities	977	(4,863)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(150)	84
CHANGE IN CASH AND CASH EQUIVALENTS	(8,536)	(12,533)
CASH AND CASH EQUIVALENTS - Beginning of the period	49,372	91,906
CASH AND CASH EQUIVALENTS - End of the period	$40,836	$79,373
SUPPLEMENTAL DISCLOSURE OF OTHER CASH FLOW INFORMATION:		
Cash paid for income taxes	$583	$1,037
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		

Purchase of property and equipment recorded in accounts payable	$2,224	$1,174
Acquisition costs in connection with NexGraph recorded in accrued expenses	$—	$375

See Notes to Condensed Consolidated Financial Statements (unaudited).

LIVEPERSON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Description of Business and Basis of Presentation

LivePerson, Inc. (the “Company” or “LivePerson”) was incorporated in the State of Delaware in November 1995 and the LivePerson service was introduced in November 1998. In April 2000, the Company completed an initial public offering and is currently traded on the Nasdaq Global Select Market and the Tel Aviv Stock Exchange. LivePerson is headquartered in New York City with offices in Amsterdam, Atlanta, Berlin, London, Mannheim, Melbourne, Milan, Ra'anana, Reading (UK), San Francisco and Tokyo.

LivePerson provides online engagement solutions offering a cloud-based platform which enables businesses to proactively connect with consumers through chat, voice and content delivery, across multiple channels and screens, including websites, social media, tablets and mobile devices. The Company’s engagements are driven by insights derived from a broad set of consumer and business data, including historical, behavioral, operational, and third party data. Each engagement is based on proprietary analytics and a real-time understanding of consumer needs and business objectives. The Company’s products, coupled with its domain knowledge and industry expertise, have been proven to maximize the effectiveness of the online channel — by increasing sales, as well as consumer satisfaction and loyalty ratings for its customers, while also enabling its customers to reduce consumer service costs.

LivePerson monitors and analyzes valuable online consumer behavioral data on behalf of its customers. Spanning the breadth of an online visitor session, starting from an initial keyword search through actions on their customer’s website, and even into a shopping cart and an executed sale, this data enables the Company to develop unique insights into consumer behavior during specific transactions within a customer’s user base.

The Company’s primary revenue source is from the sale of LivePerson services to businesses of all sizes. The Company also offers an online marketplace that connects independent service providers (“Experts”) who provide information and knowledge for a fee via real-time chat with individual consumers (“Users”).

Basis of Presentation

The accompanying condensed consolidated financial statements as of March 31, 2015 and for the three months ended March 31, 2015 and 2014 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 March 31, 2015, and the consolidated results of operations, comprehensive loss and cash flows for the interim periods ended March 31, 2015 and 2014. 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, 2014 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 in the United States (“GAAP”) 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, 2014, included in the Company’s Annual Report on Form 10-K filed with the SEC on March 12, 2015.

Principles of Consolidation

The condensed consolidated financial statements include the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of the Company’s condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of income and expenses during the reporting period. These estimates are based on information

available as of the date of the condensed consolidated financial statements; therefore, actual results could differ from management's estimates.

Recently Issued Accounting Standards

On February 18, 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-02, Consolidation: Amendments to the Consolidation Analysis ("ASU 2015-02"), which affects reporting entities

that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The standard amends the consolidation requirements in ASC 810. ASU 2015-02 is effective for fiscal periods beginning after December 15, 2015 for public companies, and early adoption is permitted. The Company does not expect to early adopt ASU 2015-02, which will be effective for its fiscal year ending December 31, 2016. The Company does not believe the standard will have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which supersedes most existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company will adopt this guidance at the beginning of its first quarter of fiscal year 2017. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

2. 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 FASB Accounting Standards Codification (“ASC”) 605-10-S99, “Revenue Recognition” and ASC 605-25, “Revenue Recognition with Multiple-Element Arrangements.” The Company charges a monthly fee, which varies by type of service, the level of customer usage and website traffic, and in some cases, the number of orders placed via the Company’s online engagement solutions.

For certain of the Company’s larger customers, the Company may provide call center labor through an arrangement with one or more of several qualified vendors. For most of these customers, the Company passes the fee it incurs with the labor provider and its fee for the hosted services through to its customers in the form of a fixed fee for each order placed via the Company’s online engagement solutions. For these Pay for Performance (“PFP”) arrangements, in accordance with ASC 605-45, “Principal Agent Considerations,” the Company records revenue for transactions in which it acts as an agent on a net basis, and revenue for transactions in which it acts as a principal on a gross basis.

The Company also sells certain of the LivePerson services directly via Internet download. These services are marketed as LiveEngage for small to medium-sized businesses, 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 LiveEngage may occur with or without the assistance of an online sales representative, rather than through face-to-face or telephone contact that is typically required for traditional direct sales.

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

For revenue from the Company's Consumer segment generated from online transactions between Experts and Users, the Company recognizes revenue net of the Expert fees in accordance with ASC 605-45, “Principal Agent

Considerations," due primarily to the fact that the Expert is the primary obligor. Additionally, the Company performs as an agent without any risk of loss for collection, and is not involved in selecting the Expert or establishing the Expert's fee. The Company collects a fee from the User and retains a portion of the fee, and then remits the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed and determinable.

3. Net Loss Per Share

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

Diluted net loss per common share for the three months ended March 31, 2015 and 2014 does not include the effect of options to purchase 10,152,741 and 9,678,582 shares of common stock, respectively, as the effect of their inclusion is anti-dilutive.

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

	Three Months Ended March 31,	
	2015	2014
Basic	56,291,383	54,666,535
Effect of assumed exercised options	—	—
Diluted	56,291,383	54,666,535

4. Segment Information

The Company accounts for its segment information in accordance with the provisions of ASC 280-10, "Segment Reporting." ASC 280-10 establishes annual and interim reporting standards for operating segments of a company. ASC 280-10 requires disclosures of selected segment-related financial information about products, major customers, and geographic areas based on the Company's internal accounting methods. The Company is organized into two operating segments for purposes of making operating decisions and assessing performance. The Business segment facilitates real-time online interactions – chat, voice and content delivery across multiple channels and screens for 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 United States. The chief operating decision maker, who is the chief executive officer, evaluates performance, makes operating decisions, and allocates resources based on the operating income of each segment. The reporting segments follow the same accounting polices used in the preparation of the Company's condensed consolidated financial statements which are described in the summary of significant accounting policies. The Company allocates cost of revenue, sales and marketing and amortization of purchased intangibles to the segments, but it does not allocate product development expenses, general and administrative expenses and income tax expense because management does not use this information to measure performance of the operating segments. There are currently no inter-segment sales.

Summarized financial information by segment for the three months ended March 31, 2015, based on the Company's internal financial reporting system utilized by the Company's chief operating decision maker, follows (amounts in thousands):

	Business	Consumer	Corporate	Consolidated
Revenue:				
Hosted services – Business	$50,613	$—	$—	$50,613
Hosted services – Consumer	—	3,696	—	3,696
Professional services	5,461	—	—	5,461
Total revenue	56,074	3,696	—	59,770
Cost of revenue	15,617	637	—	16,254
Sales and marketing	22,852	1,442	—	24,294
Amortization of purchased intangibles	1,313	—	—	1,313
Unallocated corporate expenses	—	—	19,964	19,964
Operating income (loss)	$16,292	$1,617	$(19,964)	$(2,055)

Summarized financial information by segment for the three months ended March 31, 2014, based on the Company's internal financial reporting system utilized by the Company's chief operating decision maker, follows (amounts in thousands):

	Business	Consumer	Corporate	Consolidated
Revenue:				
Hosted services – Business	$39,680	$—	$—	$39,680
Hosted services – Consumer	—	3,910	—	3,910
Professional services	4,238	—	—	4,238
Total revenue	43,918	3,910	—	47,828
Cost of revenue	11,220	515	—	11,735
Sales and marketing	16,918	1,477	—	18,395
Amortization of purchased intangibles	190	—	—	190
Unallocated corporate expenses	—	—	18,450	18,450
Operating income (loss)	$15,590	$1,918	$(18,450)	$(942)

Geographic Information

The Company is domiciled in the United States and has international operations in the United Kingdom, Asia-Pacific, Latin America and Western Europe, particularly France and Germany. The following table presents the Company's revenues attributable to domestic and foreign operations for the periods presented (amounts in thousands):

	Three Months Ended March 31,	
	2015	2014
United States	$41,442	$31,098
Other Americas [1]	2,703	2,150
Total Americas	44,145	33,248
EMEA [2]	11,784	10,515
APAC [3]	3,841	4,065
Total revenue	$59,770	$47,828

[1] Canada, Latin America and South America

[2] Europe, the Middle East and Africa ("EMEA")

[3] Asia-Pacific ("APAC")

The following table presents the Company's long-lived assets by geographic region for the periods presented (amounts in thousands):

	March 31, 2015	December 31, 2014
United States	$109,517	$109,006
Israel	18,173	18,982
Australia	8,132	8,500
Netherlands	7,709	7,686
Other [1]	1,978	1,940
Total long-lived assets	$145,509	$146,114

[1] United Kingdom, Germany, Japan and Italy

No individual customer accounted for 10% or more of consolidated revenue for any of the periods presented. One customer accounted for approximately 16% and 22% of accounts receivable as of March 31, 2015 and December 31, 2014, respectively.

5. Goodwill and Intangible Assets

Goodwill

The changes in the carrying amount of goodwill for the three months ended March 31, 2015 are as follows (amounts in thousands):

	Business	Consumer	Total
Balance as of December 31, 2014	$72,824	$8,024	$80,848
Adjustments to goodwill:			
Foreign exchange adjustment	(538)	—	(538)
Balance as of March 31, 2015	$72,286	$8,024	$80,310

The changes in the carrying amount of goodwill for the year ended December 31, 2014 are as follows (amounts in thousands):

	Business	Consumer	Total
Balance as of December 31, 2013	$24,700	$8,024	$32,724
Adjustments to goodwill:			
Acquisitions	48,124	—	48,124
Balance as of December 31, 2014	$72,824	$8,024	$80,848

Intangible Assets

Intangible assets are summarized as follows (see Note 8) (amounts in thousands):

	As of March 31, 2015			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Amortization Period
Amortizing intangible assets:				
Technology	$28,005	$ (12,379)	$15,626	5.3 years
Customer relationships	16,008	(4,818)	11,190	7.9 years
Trade names	1,287	(946)	341	2.8 years
Non-compete agreements	1,446	(721)	725	2.3 years
Patents	3,290	(584)	2,706	9.9 years
Other	312	(271)	41	3.0 years
Total	$50,348	$ (19,719)	$30,629	

	As of December 31, 2014			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Amortization Period
Amortizing intangible assets:				
Technology	$27,844	$(11,303)	$16,541	5.3 years
Customer relationships	16,008	(4,055)	11,953	7.9 years
Trade names	1,287	(817)	470	2.8 years
Non-compete agreements	1,446	(625)	821	2.3 years
Patents	3,290	(500)	2,790	9.9 years
Other	312	(267)	45	3.0 years
Total	$50,187	$(17,567)	$32,620	

Amortization expense is calculated over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was $2.2 million and $1.1 million for the three months ended March 31, 2015 and 2014, respectively. For the three months ended March 31, 2015 and 2014, respectively, a portion of this amortization is included in cost of revenue. Estimated amortization expense for the next five years is as follows (amounts in thousands):

	Estimated Amortization Expense
2015	$5,828
2016	6,755
2017	4,934
2018	2,815
2019	2,809
Thereafter	7,488
Total	$30,629

6. Property and Equipment

The following table presents the detail of property and equipment for the periods presented (amounts in thousands):

	March 31, 2015	December 31, 2014
Computer equipment and software	$59,122	$55,293
Furniture, equipment and building improvements	9,578	9,439
	68,700	64,732
Less: accumulated depreciation	(47,727)	(45,149)
Total	$20,973	$19,583

7. Accrued and Other Current Liabilities

The following table presents the detail of accrued and other current liabilities for the periods presented (amounts in thousands):

	March 31, 2015	December 31, 2014
Payroll and other employee related costs	$10,893	$15,373
Professional services and consulting and other vendor fees	9,730	9,258
Sales commissions	1,448	3,268
Contingent earnout (see Notes 8 and 9)	6,591	6,940
Other	2,869	2,933
Total	$31,531	$37,772

8. Acquisitions

Engage Pty Ltd.

On November 9, 2012, the Company acquired all of the outstanding shares of Engage Pty Ltd. (“Engage”), an Australian provider of cloud-based customer contact solutions. The transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of Engage were included in the Company’s consolidated results of operations from the date of acquisition.

The purchase price was approximately $10.6 million. The total acquisition costs incurred in the year ended December 31, 2012 were approximately $0.5 million and are included in general and administrative expenses in the Company’s condensed consolidated statements of operations for the same period. The acquisition enhances the Company’s ability to offer intelligent engagement solutions to businesses in the Asia Pacific region. Of the total purchase price, $0.8 million 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. All receivables acquired are expected to be collectible. The purchase price in excess of the fair value of the net book values of the assets acquired and liabilities assumed was allocated to intangible assets based on management's best estimate of fair values, taking into account all relevant information available at the time of acquisition, and the excess was allocated to goodwill. The goodwill is not deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. The purchase price includes approximately $1.7 million of potential earn-out consideration for the shareholders if certain revenue targets are achieved. The earn-out is payable in shares of LivePerson common stock and cash. The Company recorded the contingent earn-out as part of the purchase price. In accordance with ASC 480, the Company has classified this amount as a liability and the amount is included in accrued expenses in the March 31, 2015 condensed consolidated balance sheets, due to the variable number of shares that will be issued if and when the targets are achieved. The Company assessed this earn-out at March 31, 2015 with no change from the original estimate. There was a decrease in the liability during the quarter ended March 31, 2015 as a result of a payment made of $0.3 million. The Company will assess the earn-out calculation in future periods and any future adjustments will affect operating income.

NexGraph, LLC

On March 11, 2014, the Company acquired all the outstanding shares of NexGraph, LLC ("NexGraph"), a company focused on analytic solutions, in exchange for aggregate cash consideration of $0.5 million. Of the purchase price, $0.1 million was allocated to Intangibles, net, of which was fully amortized as of March 31, 2015; and $0.4 million of the purchase price was allocated to Goodwill.

Synchronite, LLC

On June 2, 2014, the Company acquired Synchronite, LLC ("Synchronite"), a German-based start-up that provides co-browsing technology. The transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of Synchronite were included in the Company's consolidated results of operations from the date of acquisition.

The allocation of the total purchase price of approximately $4.1 million was based upon the estimated fair value of Synchronite's net tangible and identifiable intangible assets as of the date of acquisition. The total acquisition costs incurred were approximately $0.4 million and are included in general and administrative expenses in the Company's condensed consolidated statements of operations. Of the total purchase price, $45,000 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. All receivables acquired are expected to be collectible. The purchase price includes approximately $2.7 million of goodwill and approximately $1.5 million of intangible assets. The goodwill will be deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. The purchase price includes $1.8 million of potential earn-out consideration for the shareholders if complete product integration is achieved. The earn-out is payable in shares of LivePerson common stock and cash. The Company recorded the contingent earn-out as part of the purchase price. In accordance with ASC 480, the Company has classified this amount as a liability and the amount is included in accrued expenses in the March 31, 2015 condensed consolidated balance sheet, due to the variable number of shares that will be issued if and when the targets are achieved. The Company has assessed the earn-out calculation at March 31, 2015, with no change from the original estimate, and will assess the earn-out calculation in future periods and any future adjustments will affect operating income.

The components of the intangible assets are as follows (amounts in thousands):

	Weighted Average Useful Life (Months)	Amount
Technology	120	$1,082
Trade-name	48	62
Customer relationships	84	247
Non-compete agreements	36	60
		$1,451

Contact At Once!, LLC

On November 7, 2014, the Company acquired Contact At Once!, LLC (“CAO!”), a software company with a cloud-based platform that instantly connects consumers with businesses through instant messaging, text messaging, chat, social media and video over the internet for consumer-to-business sales conversions. The transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of CAO! were included in the Company’s consolidated results of operations from the date of acquisition. The Company is in the process of finalizing all fair value and purchase accounting adjustments.

The allocation of the total purchase price of approximately $67.0 million, which includes approximately $42.8 million in cash, approximately $20.0 million in shares of common stock and approximately $4.2 million of potential earn-out consideration in cash, was based upon the estimated fair value of CAO!'s net tangible and identifiable intangible assets as of the date of acquisition. The historical carrying amounts of such assets and liabilities approximated their fair values. All receivables acquired are expected to be collectible. The purchase price includes approximately $45.1 million of goodwill and approximately $20.4 million of intangible assets. The goodwill will be deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. The purchase price includes $4.2 million of potential earn-out consideration for the shareholders if certain targeted financial, strategic and integration objectives is achieved. The earn-out is payable in cash. The Company recorded the contingent earn-out as part of the purchase price. In accordance with ASC 480, the Company has classified this amount as a liability and is included in accrued expenses in the December 31, 2014 consolidated balance sheet. The Company has assessed this earn-out at March 31, 2015, with no change from the original estimate, and will assess the earn-out calculation in future periods and any future adjustments will affect operating income.

Management's preliminary allocation of the purchase price in connection with the CAO! acquisition is as follows (amounts in thousands):

Cash	$480
Accounts receivable	2,694
Other currents assets	289
Property and equipment	231
Other assets	43
Intangible assets	20,400
Goodwill	45,064
	69,201
Liabilities assumed	(2,203)
Total purchase price consideration	$66,998

The components of the intangible assets are as follows (amounts in thousands):

	Weighted Average Useful Life (Months)	Amount
Technology	96	$8,400
Trade-name	12	500
Customer relationships	120	10,700
Non-compete agreements	36	800
		$20,400

9. Fair Value Measurements

The Company measures its cash equivalents at fair value based on an expected exit price as defined by the authoritative guidance on fair value measurements, which represents the amount that would be received on the sale of an asset or paid to transfer a liability, as the case may be, in an orderly transaction between market participants. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability. The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

- Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Inputs reflect: quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Unobservable inputs reflecting the Company's assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are

reasonably available.

Financial Assets and Liabilities

The Company's assets and liabilities that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of March 31, 2015 and December 31, 2014, are summarized as follows (amounts in thousands):

	March 31, 2015				December 31, 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Money market funds	$3,088	$—	$—	$3,088	$3,987	$—	$—	$3,987
Total assets	$3,088	$—	$—	$3,088	$3,987	$—	$—	$3,987
Liabilities:								
Contingent earn-out	$—	$—	$6,590	$6,590	$—	$—	$6,940	$6,940
Foreign currency derivative contracts	—	423	—	423	—	—	—	—
Total liabilities	$—	$423	$6,590	$7,013	$—	$—	$6,940	$6,940

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value. Observable or market inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions based on the best information available.

The Company's only asset that is measured at fair value on a recurring basis is money market funds, based on quoted market prices in active markets and therefore classified as level 1 within the fair value hierarchy. The Company's contingent earn-out liability and foreign currency derivative contract liability are measured at fair value on a recurring basis and are classified as level 3 and level 2, respectively, within the fair value hierarchy. On a nonrecurring basis, the Company uses fair value measures when analyzing asset impairment. Long-lived tangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If it is determined such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization periods, their carrying values are reduced to estimated fair value. The Company uses an income approach and inputs that constitute level 3. During the third quarter of each year, the Company evaluates goodwill for impairment at the reporting unit level. The Company uses a combination of discounted cash flows and other qualitative factors in accordance with ASU No. 2011-08 to determine whether it is “more likely than not” that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This measurement is classified based on level 3 input.

The contingent earn-out in connection with the acquisition of Engage is $0.7 million and $0.9 million as of March 31, 2015 and December 31, 2014, respectively, and is recorded in accrued expenses in the condensed consolidated balance sheets. This earn-out is based on the potential earn-out consideration if certain revenue targets are achieved. The contingent earn-out balance was increased by $1.8 million in June 2014 in connection with the acquisition of Synchronite and $4.2 million in November 2014 in connection with the acquisition of CAO!. The contingent earn-out amounts are recorded in accrued expense on the condensed consolidated balance sheets as they are payable in 2015. The contingent earn-out relating to Synchronite is based on the fulfillment of a complete product integration and a minimum number of “Co-Browse” interactions per month. The contingent earn-out relating to CAO! is based on achieving certain target financial, strategic and integration objectives and milestones.

The changes in fair value of the Level 3 liabilities are as follows (amounts in thousands):

	Contingent Earn-Out	
	March 31, 2015	December 31, 2014
Balance, Beginning of Period	$6,940	$1,660
Synchronite addition (see Note 8)	—	1,810
CAO! addition (see Note 8)	—	4,220
Cash payment	(350)	(750)

Balance, End of Period	$6,590	$6,940

16

Derivative Financial Instruments

The Company is exposed to foreign exchange risks that in part are managed by using derivative financial instruments. Beginning January 2015, the Company entered into foreign currency forward contracts related to risks associated with foreign operations. The Company does not use derivatives for trading purposes and at March 31, 2015 has no derivatives that are designated as fair value hedges. Derivatives are recorded at their estimated fair values based upon Level 2 inputs. Derivatives designated and effective as cash flow hedges are reported as a component of other comprehensive income and reclassified to earnings in the same periods in which the hedged transactions impact earnings. Gains and losses related to derivatives not meeting the requirements of hedge accounting and the portion of derivatives related to hedge ineffectiveness are recognized in current earnings.

The following summarizes certain information regarding the Company’s outstanding foreign currency derivative contracts related primarily to intercompany receivables and payables for the periods presented (in thousands):

	March 31, 2015	March 31, 2014
Notional amount of foreign currency derivative contracts	$38,236	$—
Fair value of foreign currency derivatives contracts	$423	$—

The fair value of the Company's derivative instruments are summarized below (in thousands):

		Fair Value of Derivative Instruments	
	Balance Sheet Location	March 31, 2015	March 31, 2014
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign currency derivatives contracts	Accrued expenses and other liabilities	$423	$—

The following summarizes certain information regarding the Company’s derivatives that are not designated or are not effective as hedges (in thousands):

	Gain (losses) on Derivative Instruments Recognized in Income Statement		
	Location	March 31, 2015	March 31, 2014
Foreign currency derivatives contracts	Other expense	$7	$—

10. Commitments and Contingencies

Contractual Obligations

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 months ended March 31, 2015 and 2014 was approximately $2.5 million and $2.2 million, respectively.

Employee Benefit Plans

The Company has a 401(k) defined contribution plan covering all eligible employees. The Company provides for employer matching contributions equal to 50% of employee contributions, up to the lesser of 5% of eligible compensation or $6,000. Matching contributions are deposited into the employee’s 401(k) account and are subject to 5 year graded vesting. Salaries and related expenses include $0.4 million and $0.3 million of employer matching contributions for the three months ended March 31, 2015 and 2014, respectively.

11. Stockholders' Equity

Common Stock

As of March 31, 2015, there were 100,000,000 shares of common stock authorized, and 57,039,125 shares issued and outstanding. As of December 31, 2014, there were 100,000,000 shares of common stock authorized, and 56,701,331 shares issued and outstanding. The par value for common shares is $0.001.

Preferred Stock

As of March 31, 2015 and December 31, 2014, there were 5,000,000 shares of preferred stock authorized, and zero shares issued and outstanding. The par value for preferred shares is $0.001.

Stock Repurchase Program

On December 10, 2012, the Company's Board of Directors approved a stock repurchase program through June 30, 2014. Under the stock repurchase program, the Company is authorized to repurchase shares of its common stock, in the open market or privately negotiated transactions, at times and prices considered appropriate by the Board of Directors depending upon prevailing market conditions and other corporate considerations. On March 13, 2014, the Company's Board of Directors increased the aggregate purchase price of the stock repurchase program from $30.0 million to $40.0 million. On July 23, 2014, the Company's Board of Directors increased the aggregate purchase price of the stock repurchase program from $40.0 million to $50.0 million. On March 5, 2015, the Company's Board of Directors extended the expiration date of the program out to December 31, 2016. There were 176,172 shares repurchased under this program during 2015, of which 33,360 shares were recorded in treasury stock at par on the condensed consolidated balance sheets as of March 31, 2015. As of March 31, 2015, approximately $8.2 million remained available for purchase under the program.

Stock-Based Compensation

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

The following table summarizes stock-based compensation expense related to employee stock options under ASC 718-10 included in Company's statements of operations for the periods presented (amounts in thousands):

	Three Months Ended March 31,	
	2015	2014
Cost of revenue	$328	$360
Sales and marketing expense	595	814
Product development expense	939	680
General and administrative expense	932	843
Total stock based compensation included in costs and expenses	$2,794	$2,697

The per share weighted average fair value of stock options granted during the three months ended March 31, 2015 and 2014 was $4.64 and $6.25, 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 March 31,	
	2015	2014
Dividend yield	0.0%	0.0%
Risk-free interest rate	1.3%	1.5%
Expected life (in years)	5	5
Historical volatility	49.7%	53.7%

A description of the methods used in the significant assumptions used to estimate the fair value of stock-based compensation awards follows:

Dividend yield – The Company uses 0% as it has never issued dividends and does not anticipate issuing dividends in the near term.

Risk-free interest rate – The Company uses the market yield on U.S. Treasury securities at five years with constant maturity, representing the current expected life of stock options in years.

Expected life – The Company uses historical data to estimate the expected life of a stock option.

Historical volatility – The Company uses a trailing five year from grant date to determine volatility.

Stock Option 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 2000 Stock Incentive Plan (the "2000 Plan") succeeded the 1998 Plan. Under the 2000 Plan, the options which had been outstanding under the 1998 Plan were incorporated in the 2000 Plan increasing the number of shares available for issuance under the plan by approximately 4,150,000, thereby reserving for issuance 10,000,000 shares of common stock in the aggregate.

The Company established the 2009 Stock Incentive Plan (as amended and restated, the "2009 Plan") as a successor to the 2000 Plan. Under the 2009 Plan, the options which had been outstanding under the 2000 Plan were incorporated into the 2009 Plan and the Company increased the number of shares available for issuance under the plan by 6,000,000. The Company amended the 2009 stock incentive plan (the "Amended 2009 Plan") effective June 7, 2012. The Amended 2009 Plan increased the number of shares authorized for issuance under the plan by an additional 4,250,000, thereby reserving for issuance 23,817,744 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have 10-year terms. As of March 31, 2015, approximately 13,100,000 shares of common stock were reserved for issuance under the 2009 Plan (taking into account all option exercises through March 31, 2015).

Employee Stock Purchase Plan

In June 2010, the Company's stockholders approved the 2010 Employee Stock Purchase Plan with 1,000,000 shares of common stock initially reserved for issuance. As of March 31, 2015, approximately 519,000 shares of common stock were reserved for issuance under the Employee Stock Purchase Plan (taking into account all share purchases through March 31, 2015).

Stock Option Activity

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

	Stock Option Activity		Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
	Options	Weighted Average Exercise Price		
Balance outstanding at December 31, 2014	10,769,149	$10.95		
Granted	434,550	10.53		
Exercised	(430,533)	4.03		
Cancelled or expired	(620,425)	12.38		
Balance outstanding at March 31, 2015	10,152,741	$11.13	7.31	$9,027
Options vested and expected to vest at March 31, 2015	8,600,976	$11.13	7.01	$8,766
Options exercisable at March 31, 2015	4,354,151	$10.50	5.68	$7,900

The total fair value of stock options exercised during the three months ended March 31, 2015 was approximately $1.1 million. As of March 31, 2015, there was approximately $25.6 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 2.6 years.

A summary of the status of the Company's nonvested shares as of December 31, 2014, and changes during the three months ended March 31, 2015 is as follows:

	Options	Weighted Average Grant-Date Fair Value
Nonvested Shares at December 31, 2014	6,032,315	$ 5.66
Granted	434,550	4.64
Vested	(47,850)	5.10

Cancelled or expired	(620,425)	6.09
Nonvested Shares at March 31, 2015	5,798,590	$ 5.59

The total intrinsic value of nonvested options at March 31, 2015 was approximately $1.1 million.

12. Legal Matters

The Company routinely assesses all of its litigation and threatened litigation as to the probability of ultimately incurring a liability, and records its best estimate of the ultimate loss in situations where the Company assesses the likelihood of loss as probable.

From time to time, the Company is involved in or subject to legal, administrative and regulatory proceedings, claims, demands and investigations arising in the ordinary course of business, including direct claims brought by or against the Company with respect to intellectual property, contracts, employment and other matters, as well as claims brought against the Company's customers for whom the Company has a contractual indemnification obligation. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. In addition, in the event the Company determines that a loss is not probable, but is reasonably possible, and it becomes possible to develop what the Company believes to be a reasonable range of possible loss, then the Company will include disclosures related to such matter as appropriate and in compliance with ASC 450. The accruals or estimates, if any, resulting from the foregoing analysis, are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company will, as applicable, adjust the accrual in the period the determination is made, disclose an estimate of the additional loss or range of loss, indicate that the estimate is immaterial with respect to its financial statements as a whole or, if the amount of such adjustment cannot be reasonably estimated, disclose that an estimate cannot be made.

From time to time, third parties assert claims against the Company regarding intellectual property rights, privacy issues and other matters arising out of the ordinary course of business. Although the Company cannot be certain of the outcome of any litigation or the disposition of any claims, nor the amount of damages and exposure, if any, that the Company could incur, the Company currently believes that the final disposition of all existing matters will not have a material adverse effect on our business, results of operations, financial condition or cash flows. In addition, in the ordinary course of our business, the Company is also subject to periodic threats of lawsuits, investigations and claims. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources and other factors.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

Our discussion and analysis of our financial condition and results of operations are based upon our 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 condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions relate to estimates of the carrying amount of goodwill, intangibles, stock based-compensation, valuation allowances for deferred income taxes, accounts receivable, the expected term of a customer relationship, accruals and other factors. We evaluate these estimates on an ongoing basis. Actual results could differ from those estimates under different assumptions or conditions, and any differences could be material.

Overview

LivePerson was incorporated in the State of Delaware in November 1995 and the LivePerson service was introduced initially in November 1998. We provide online engagement solutions offering a cloud-based platform which enables businesses to proactively connect with consumers through chat, voice and content delivery, across multiple channels and screens, including websites, social media, tablets and mobile devices. We are organized into two operating segments: Business and Consumer. The Business segment facilitates real-time online interactions — chat, voice and content delivery, across multiple channels and screens for global corporations of all sizes. The Consumer segment facilitates online transactions between independent service providers (“Experts”) and individual consumers (“Users”) seeking information and knowledge for a fee via real-time chat.

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

- Expanding Business with Existing Customers and Adding New Customers. We are expanding our sales capacity by adding enterprise and midmarket sales agents. We have also expanded our efforts to retain existing self-service customers through increased interaction with them during the early stages of their usage of our services.
- Introducing New Products and Capabilities. We are investing in product marketing, research and development and executive personnel to support our expanding efforts to build and launch new products and capabilities to support existing customer deployments, and to further penetrate our total addressable market. These investments are initially focused in the areas of online marketing and mobile consumer engagement enhanced data and reporting and chat transcript text analysis. Over time, we expect to develop and launch additional capabilities that leverage our existing market position as a leader in proactive, intelligence-driven online engagement.
- Expanding our International Presence. We continue to increase our investment in sales and support personnel in the United Kingdom, Asia-Pacific, Latin America and Western Europe, particularly France and Germany. We are also working with sales and support partners as we expand our investment in the Asia-Pacific region. We continue to improve the multi-language and translation capabilities within our hosted solutions to further support international expansion.

Key Metrics

Financial overview of the three months ended March 31, 2015 compared to the three months ended March 31, 2014:

- Total revenue increased 25% to $59.8 million from $47.8 million.
- Revenue from our Business segment increased 28% to $56.1 million from $43.9 million.
- Gross profit margin decreased to 72.8% from 75.5%.
- Cost and expenses increased 27% to $61.8 million from $48.8 million.
- Net loss increased to $2.1 million from net loss of $0.8 million.
-

Revenue per enterprise and mid-market customer averaged $174,000 over the trailing twelve months ended March 31, 2015, a 3% sequential increase as compared to the $168,000 calculated for the period ended December 31, 2014. These figures are pro forma to exclude contributions from one large customer contract that ended.

- Customer renewal rate for enterprise and mid-market customers was 89% over the trailing twelve months ended March 31, 2015, as compared to 91% over the trailing twelve months ended December 31, 2014.

Adjusted EBITDA and Adjusted Net Income

To provide investors with additional information regarding our financial results, we have disclosed adjusted EBITDA and adjusted net income which are non-GAAP financial measures. The tables below present a reconciliation of adjusted EBITDA and adjusted net income to net loss, the most directly comparable GAAP financial measures.

We have included adjusted EBITDA and adjusted net income in this Quarterly Report on Form 10-Q because these are key measures used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA and adjusted net income can provide a useful measure for period-to-period comparisons of our core business. Additionally, adjusted EBITDA is a key financial measure used by the compensation committee of our board of directors in connection with the payment of bonuses to our executive officers. Accordingly, we believe that adjusted EBITDA and adjusted net income provide useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not consider the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA does not reflect tax payments that may represent a reduction in cash available to us; and
- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

Because of these limitations, you should consider adjusted EBITDA alongside other financial performance measures, including various cash flow metrics, net loss and our other GAAP results. The following table presents a reconciliation of adjusted EBITDA for each of the periods indicated (amounts in thousands):

	Three Months Ended March 31,	
	2015	2014
Reconciliation of Adjusted EBITDA		
GAAP net loss	$(2,058)	$(794)
Amortization of purchased intangibles	2,152	1,058
Stock-based compensation	2,794	2,697
Depreciation	2,578	1,981
Benefit from income taxes	(228)	(231)
Other expense, net	231	83
Adjusted EBITDA	$5,469	$4,794

Our use of adjusted net income has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:

- although amortization are non-cash charges, the assets being amortized may have to be replaced in the future, and adjusted net income does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted net income does not consider the potentially dilutive impact of equity-based compensation;
- other companies, including companies in our industry, may calculate adjusted net income differently, which reduces its usefulness as a comparative measure.

Because of these limitations, you should consider adjusted net income alongside other financial performance measures, including various cash flow metrics, net loss and our other GAAP results. The following table presents a reconciliation of adjusted net income for each of the periods indicated (amounts in thousands):

	Three Months Ended March 31,	
	2015	2014
Reconciliation of Adjusted Net Income		
GAAP net loss	$(2,058)	$(794)
Amortization of purchased intangibles	2,152	1,058
Stock-based compensation	2,794	2,697
Income tax effect of non-GAAP items [1]	(526)	(422)
Adjusted net income	$2,362	$2,539

[1] The Company's income tax effect does not include discrete items.

Critical Accounting Policies and Estimates

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

Revenue Recognition

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

For certain of our larger customers, we may provide call center labor through an arrangement with one or more of several qualified vendors. For most of these customers, we pass the fee we incur with the labor provider and our fee for the hosted services through to our customers in the form of a fixed fee for each order placed via our online engagement solutions. For these Pay for Performance (“PFP”) arrangements, in accordance with ASC 605-45, “Principal Agent Considerations,” we record revenue for transactions in which we act as an agent on a net basis, and revenue for transactions in which we act as a principal on a gross basis.

We also sell certain of the LivePerson services directly via Internet download. These services are marketed as LiveEngage for small to medium-sized businesses, 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 LiveEngage 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, in some cases, are terminable or may terminate upon 30 to 90 days’ notice without penalty. When professional service fees add value to the customer on a standalone basis, we recognize professional service fees upon completion and customer acceptance. ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. If a professional services arrangement does not qualify for separate accounting, we recognize the fees, and the related labor costs, ratably over the contracted period.

For revenue from our Consumer segment generated from online transactions between Experts and Users, we recognize revenue net of Expert fees in accordance with ASC 605-45, “Principal Agent Considerations,” due primarily to the fact that the Expert is the primary obligor. Additionally, we perform as an agent without any risk of loss for collection, and are not involved in selecting the Expert or establishing the Expert’s fee. We collect a fee from the consumer and retain a portion of the fee, and then remit the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting

receivable is probable and the amount of fees to be paid is fixed or determinable.

Stock-Based Compensation

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

As of March 31, 2015, there was approximately $25.6 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 2.6 years.

Accounts Receivable

Our customers are located primarily in the United States. We perform ongoing credit evaluations of our customers’ financial condition (except for customers who purchase the LivePerson services by credit card via Internet download) and have established an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information that we believe to be reasonable, although they may change in the future. If there is a deterioration of a customer’s credit worthiness or actual write-offs are higher than our historical experience, our estimates of recoverability for these receivables could be adversely affected. Although our large number of customers limits our concentration of credit risk we do have several large customers. If we experience a significant write-off from one of these large customers, it could have a material adverse impact on our condensed consolidated financial statements. No single customer accounted for or exceeded 10% of our total revenue in the three months ended March 31, 2015 and 2014. One customer accounted for approximately 16% and 22% of accounts receivable as of March 31, 2015 and December 31, 2014, respectively. We increased our allowance for doubtful accounts by $0.1 million in the three months ended March 31, 2015, principally due to an increase in sales.

A large portion of receivables are due from larger corporate customers that typically have longer payment cycles.

Goodwill

In accordance with ASC 350, “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. In September 2011, the FASB issued ASU No. 2011-08, Intangibles — Goodwill and Other (Topic 350). ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is “more likely than not” that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. If it is determined that the fair value of a reporting unit is more likely than not to be less than its carrying value (including unrecognized intangible assets) than it is necessary to perform the second step of the goodwill impairment test. 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. We perform internal valuation analysis 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.

We evaluate for goodwill impairment annually at September 30th. At the end of the third quarter of 2014, we determined that it was not more-likely that the fair value of the reporting units are less than their carrying amount. Accordingly, we did not perform the two-step goodwill impairment test.

Impairment of Long-Lived Assets

In accordance with ASC 360-10, “Accounting for the Impairment or Disposal of Long-lived Assets,” long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization are reviewed for impairment

whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. The Company does not have any long-lived assets, including intangible assets, which it considered to be impaired.

Legal Contingencies

We are subject to legal proceedings and litigation arising in the ordinary course of business. Periodically, we evaluate the status of each legal matter and assess our potential financial exposure. If the potential loss from any legal proceeding or litigation is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment

is required to determine the probability of a loss and whether the amount of the loss is reasonably estimable. The outcome of any proceeding is not determinable in advance. As a result, the assessment of a potential liability and the amount of accruals recorded are based only on the information available at the time. As additional information becomes available, we reassess the potential liability related to the legal proceeding or litigation, and may revise our estimates. Any revisions could have a material effect on our results of operations. See Note 12, Legal Matters, of the Notes to the Consolidated Financial Statements additional information on our legal proceedings and litigation.

Recently Issued Accounting Standards

On February 18, 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-02, Consolidation: Amendments to the Consolidation Analysis ("ASU 2015-02"), which affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The standard amends the consolidation requirements in ASC 810. ASU 2015-02 is effective for fiscal periods beginning after December 15, 2015 for public companies, and early adoption is permitted. We do not expect to early adopt ASU 2015-02, which will be effective for our fiscal year ending December 31, 2016. We do not believe the standard will have a material impact on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which supersedes most existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). We will adopt this guidance at the beginning of its first quarter of fiscal year 2017. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

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 customer usage. The majority of our larger customers also pay a professional services fee related to implementation. A large proportion of our revenue from new customers comes from large corporations. These companies typically have more significant implementation requirements and more stringent data security standards. Such customers also have more sophisticated data analysis and performance reporting requirements, and are likely to engage our professional services organization to provide such analysis and reporting on a recurring basis.

Revenue from our Business segment accounted for 94% and 92% of total revenue for the three months ended March 31, 2015 and 2014, respectively. Revenue attributable to our monthly hosted Business services accounted for 90% of total Business revenue for the three months ended March 31, 2015 and 2014, respectively. Our service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days' notice without penalty. Given the time required to schedule training for our customers' operators and our customers' resource constraints, we have historically experienced a lag between signing a customer contract and recognizing revenue from that customer. Although this lag typically ranges from 30 to 90 days, it may take more time between contract signing and recognizing revenue in certain situations.

Revenue from our Consumer segment is generated from online transactions between Experts and Users and is recognized net of Expert fees and accounted for approximately 6% and 8% of total revenue for the three months ended March 31, 2015 and 2014, respectively.

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

been material.

Costs and Expenses

Our cost of revenue consists of:

- compensation costs relating to employees who provide customer support and implementation services to our customers;
- outside labor provider costs;
- compensation costs relating to our network support staff;
- depreciation of certain hardware and software;

25

- allocated occupancy costs and related overhead;
- the cost of supporting our infrastructure, including expenses related to server leases, infrastructure support costs and Internet connectivity;
- the credit card fees and related payment processing costs associated with consumer and self-service customers; and
- amortization of certain intangibles.

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, information technology and human resources personnel, allocated occupancy costs and related overhead, professional fees, provision for doubtful accounts and other general corporate expenses.

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.

During the three months ended March 31, 2015, we increased our allowance for doubtful accounts by approximately $0.1 million to approximately $1.4 million. During 2014, we increased our allowance for doubtful accounts by $0.1 million to approximately $1.3 million, principally due to an increase in the proportion of receivables due as a result of an increase in sales. A large proportion of receivables are due from larger corporate customers that typically have longer payment cycles. We base our allowance for doubtful accounts on specifically identified credit risks of customers, historical trends and other information that we believe to be reasonable. We adjust our allowance for doubtful accounts when accounts previously reserved have been collected.

Non-Cash Compensation Expense

The net non-cash compensation amounts are as follows:

	Three Months Ended March 31,	
	2015	2014
	(in thousands)	
Stock-based compensation expense related to ASC 718-10	$2,794	$2,697

Results of Operations

The Company is organized into two operating segments: Business and Consumer. The Business segment facilitates real-time online interactions — chat, voice and content delivery, across multiple channels and screens for global corporations of all sizes. The Consumer segment facilitates online transactions between Experts and Users seeking information and knowledge for a fee via real-time chat.

Comparison of the Three Months Ended March 31, 2015 and 2014

Revenue

	Three Months Ended March 31,		
	2015	2014	% Change
	(in thousands)		
Revenue by Segment:			
Business	$56,074	$43,918	28 %
Consumer	3,696	3,910	(5)%
Total	$59,770	$47,828	25 %

Our business revenue growth has traditionally been driven by a mix of revenue from new customers as well as expansion from existing customers. The mix of revenue between new and existing customers is consistent with prior quarters. Business revenue increased by 28% to $56.1 million in the three months ended March 31, 2015, from $43.9 million in the comparable

period in 2014. The increase in revenue from new customers was approximately $8.6 million; revenue from existing customers who increased their use of our services was approximately $2.4 million, net of cancellations; and professional services revenue increased by approximately $1.2 million.

Consumer revenue decreased by 5% to $3.7 million in the three months ended March 31, 2015, from $3.9 million in the comparable period in 2014. The decrease was driven by the price charged per minute partially offset by an increase in the fees we charge experts.

Cost of Revenue - Business

Cost of revenue consists of compensation costs relating to employees who provide customer service to our customers, compensation costs relating to our network support staff, outside labor provider costs, the cost of supporting our server and network infrastructure, and allocated occupancy costs and related overhead.

	Three Months Ended March 31,		
	2015	2014	% Change
	($ in thousands)		
Cost of revenue - business	$15,617	$11,220	39 %
Percentage of total revenue	26 %	23 %	