

LIVEPERSON INC  
Form 10-K  
March 15, 2011

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

**FORM 10-K**

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

**For the Fiscal Year Ended December 31, 2010**

**OR**

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

**For the Transition Period from to .**

**Commission File Number 000-30141**

**LIVEPERSON, INC.**

(Exact Name of Registrant As Specified in Its Charter)

Delaware  
(State of Incorporation)

13-3861628  
(I.R.S. Employer Identification Number)

**462 Seventh Avenue, 3rd Floor,  
New York, New York 10018**

(Address of Principal Executive Offices) (Zip Code)

**(212) 609-4200**

(Registrant's Telephone Number, Including Area Code)

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

| Title of Each Class                       | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, par value \$0.001 per share | The Nasdaq Stock Market LLC               |

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

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

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

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
 No

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2010 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$196,732,898 (computed by reference to the last reported sale price on The Nasdaq Capital Market on that date). The registrant does not have any non-voting common stock outstanding.

On March 1, 2011, 52,199,178 shares of the registrant's common stock were outstanding.

## **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for the 2011 Annual Meeting of Stockholders, to be filed not later than April 30, 2011, are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K.

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**2010 ANNUAL REPORT ON FORM 10-K**

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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 ITEM 1A, RISK FACTORS.

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## **PART I**

### **Item 1. Business**

#### **Overview**

LivePerson is a leading provider of online engagement solutions that facilitate real-time assistance and expert advice.

Connecting businesses and independent service providers ( Experts ) with consumers seeking help on the Web, LivePerson's hosted software platform creates more relevant, compelling and personalized online experiences. LivePerson's proprietary chat, voice, email and self-service/knowledgebase applications, coupled with our domain knowledge and industry expertise, have been proven to maximize the effectiveness of the online channel by increasing sales, as well as customer satisfaction and loyalty ratings for our customers, while also enabling them to reduce customer service costs.

LivePerson manages a unique set of online consumer behavioral data on behalf of our customers. Spanning the breadth of an online visitor session starting from an initial keyword search, through a customer's website, and even into a shopping cart and an executed sale, this data enables us to develop unique insights into consumer behavior during specific transactions, within a customer's user base and even across significant industry verticals like financial services, telecommunications, technology and retail. Based on our internal measures, in December 2010, we hosted more than 1.3 billion visitor sessions per month across our customers' websites. Today this session data is primarily used to proactively engage consumers in order to increase online conversion rates and average order values, and we continue to invest in opportunities to leverage the value of this data in new and innovative ways for our customers.

More than 8,500 companies, including Cisco, Hewlett-Packard, IBM, Microsoft, Qwest and Verizon, employ our technology to keep pace with rising consumer expectations for the online channel. As a result, LivePerson has unique insight into consumer behavior, which we leverage to improve our product and educate our customers through our consulting services.

Bridging the gap between visitor traffic and successful business outcomes, our business solutions deliver measurable return on investment by enabling clients to:

- increase conversion rates and reduce abandonment by selectively engaging website visitors;
- accelerate the sales cycle, drive repeat business and increase average order values;
- increase customer satisfaction, retention and loyalty while reducing customer service costs;
- harness the knowledge of subject-matter experts by allowing consumers to engage with major online brands and independent experts;
- refine and improve performance by understanding which initiatives deliver the highest rate of return; and
- lower operating costs in the call center by deflecting costly phone and email interactions.

As a cloud computing or software-as-a-service (SaaS) provider, LivePerson provides solutions on a hosted basis. This model offers significant benefits over premise-based software, including lower up-front costs, faster implementation, lower total cost of ownership (TCO), scalability, cost predictability and simplified upgrades. Organizations that adopt multi-tenant architecture that is fully hosted and maintained by LivePerson eliminate the time, server infrastructure costs and IT resources required to implement, maintain and support traditional on-premise software. According to Gartner, Inc. a leading information technology research firm, 90% of e-commerce sites will rely on at least one SaaS solution by 2013, while 40% of all e-commerce sites will rely entirely on SaaS solutions by that same year.

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Our consumer services offering is an online marketplace that connects independent experts and individual service providers who provide information and knowledge for a fee via real-time chat with consumers. Users seek assistance and advice in various categories including personal counseling and coaching, computers and programming, health and medicine, education and tutoring, shopping, professional development, spirituality and religion, business and finance, arts and creative services, legal services, home and leisure, and other topics.

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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 NASDAQ and the Tel Aviv Stock Exchange. LivePerson is headquartered in New York City with offices in Atlanta, London, San Francisco and Tel Aviv.

## **Market Opportunity**

While many sectors of the global economy are challenged to maintain historical growth rates, worldwide e-commerce continues to grow steadily. According to a Goldman Sachs report, sales over the Internet will reach \$963 billion by 2013, growing at an annual rate of 19.4% and online retail is growing faster than retail sales and its share of total retail continues to expand. Furthermore, Forrester Research indicates interesting opportunities in the Asia Pacific region. For example, Australian online retail sales are predicted to double from AU\$16.9 billion in 2009 to AU\$33.3 billion in 2015. According to Forrester, online spending in Japan hit \$45 billion in 2010 and is growing at a faster rate than Europe's largest market, the United Kingdom.

The rise of online video and social media has stimulated Internet advertising spending, which is predicted to exceed \$70 billion in 2011, according to media services group, ZenithOptimedia. According to Forrester Research, almost one in five online U.S. consumers reportedly used chat in the past 12 months and 44% of online consumers state that having their questions answered by a live person while shopping online is one of the most important features a web site can provide. Nineteen percent of online customers have used online chat while shopping and 29% express interest in using chat, according to Forrester.

We believe that the positive trends in e-commerce described above, along with the diversifying channels of consumer engagement worldwide all offer LivePerson opportunities to expand. LivePerson continues to deliver increased value to customers through its core product while also seeking to expand the availability and integration of this product through different channels, such as mobile and social. By seeking to offer our solutions through different channels of engagement, we are improving the convenience and accessibility of our solutions, responding to the reality of today's online market.

We also believe that demographics shifts favor LivePerson's current and planned offerings. According to Forrester Research, members of Generation Y are dedicated consumers of online content; most use multiple technologies for online communications such as email, social networking and text messaging, and create and share user-generated content. Forrester also indicates that this demographic is demanding, with high expectations for the services they purchase via the Web which may in turn accelerate the demand for LivePerson's online, real-time customer engagement solutions.

## **Strategy**

The key elements of LivePerson's business solutions strategy include:

### ***Strengthening Our Position in Both Existing and New Markets and Growing Our Recurring Revenue***

**Base.** LivePerson plans to continue to develop its market position by significantly increasing its client base, and expanding within its existing installed base. We will continue to focus primarily on key target markets: financial services, retail, telecommunications, technology and travel/hospitality within both our enterprise and midmarket market sectors, as well as the small and midsize business (SMB) sector. Healthcare, insurance and energy utilities are new target industries and natural extensions of our primary target markets. As the online community is increasingly exposed to the benefits and functionality of our solutions, we intend to capitalize on our growing base of existing

clients by collaborating with them to optimize our added value and effectiveness. Continuing to grow our client base will enable us to strengthen our recurring revenue stream.

***Expanding the Engagement Tools We Provide to Customers.*** We are in the process of creating new applications, beyond chat, that will leverage our real-time intelligence platform and existing infrastructure in new ways. Today, using our real-time intelligence platform, our customers intelligently engage approximately two percent of their website visitors via chat. As part of our current strategy, we are striving to provide our customers with the ability to intelligently engage a greater proportion of their website visitors in new ways, such as delivery of content using our real-time intelligence platform. In addition to having our own applications in development, we have recently added APIs to our real-time intelligence platform in order to allow third parties to develop applications as well. We are in the process of cultivating a community of

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developers capable of offering additional applications to our customers, and we are beginning to see some initial use of these third party applications by our customer base.

***Maintaining Market Leadership Through Product Innovation, a Partner Ecosystem and Security Expertise.*** As described above, we are devoting significant resources to creating new products and enabling technologies designed to accelerate innovation and delivery of new products and technologies to our client base. We evaluate emerging technologies and industry standards and continually update our technology in order to retain our leadership position in each market we serve. We monitor legal and technological developments in the area of information security and confidentiality to ensure our policies and procedures meet or exceed the demands of the world's largest and most demanding corporations. We believe that these efforts will allow us to effectively anticipate changing client and end-user requirements in our rapidly evolving industry.

***Expanding our International Presence.*** During 2010, we continued our investment in direct sales and services personnel to expand our customer base in the United Kingdom and Western Europe, including expansion within several of the largest financial services and telecommunications companies in this region. We currently plan to continue to invest in our operations in this region in 2011. We have also continued our efforts to evaluate partnership opportunities and sales and marketing strategies to support expansion into the Asia-Pacific region, and currently plan to increase our investment in and management focus on these efforts during 2011. We currently have a partner supporting our sales, marketing and support efforts in the Asia-Pacific region, based in Melbourne, with initial focus on Australia, New Zealand, the Philippines and Singapore.

***Continuing to Build Brand Recognition.*** As a pioneer of real-time engagement, LivePerson enjoys strong brand recognition and credibility. We strategically target decision makers and influencers within key vertical markets, leveraging customer successes to generate increased awareness and demand for online engagement tools. In addition, we continue to develop relationships with the media, industry analysts and relevant business associations to reinforce our position and leadership within the industry. Our brand name is also visible to both business users and consumers. When a visitor engages in a text-based chat on a customer's website, our brand name is displayed on the LivePerson dialogue window. We believe that this high-visibility placement will continue to create brand awareness and increased demand for our solutions.

***Increasing the Value of Our Service to Our Clients.*** We regularly add new features and functionality to our services to further enhance value to our customers. Because we directly manage the server infrastructure, we can make new features available to our clients immediately upon release, without client or end-user installation of software or hardware. We continue to enhance our reporting, analysis and administrative tools as part of our overall portfolio of services, as well as our ability to capture, analyze and report on the substantial amount of online activity data we collect on behalf of our clients to further our clients' online strategies. Our clients may use these capabilities to increase productivity, manage call center staffing, develop one-to-one marketing tactics and pinpoint sales opportunities. Through these and other innovations, we intend to reinforce our value proposition to clients, which we believe will result in additional revenue from new and existing clients over time.

***Evaluating Strategic Alliances and Acquisitions When Appropriate.*** In April 2010, we acquired Tel Aviv-based NuConomy Ltd. to accelerate certain R&D efforts and to strengthen expertise in the area of online behavioral analytics. We continue to seek opportunities to form strategic alliances with, or to acquire, other companies that can accelerate our growth or broaden our product offerings. We have successfully integrated several acquisitions over the past decade. While we have in the past, and may from time to time in the future, engage in discussions regarding or pursue acquisitions or strategic alliances, we currently have no binding commitments with respect to any future acquisitions or strategic alliances and we are not currently engaged in any material negotiations with respect to these types of opportunities.



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## Products and Services

LivePerson's hosted platforms support and manage real-time online interactions for businesses and independent experts. With our business-to-business services, chat, voice/click-to-call, email and self-service/knowledgebase are managed from a single agent desktop. By supplying a complete, unified customer history, our solutions enable businesses to deliver a relevant, timely, personalized, and seamless customer experience. In addition to product offerings, LivePerson provides professional services and value-added business consulting to support complete deployment and optimization of our enterprise solutions.

***LivePerson Enterprise for Sales.*** LivePerson Enterprise for Sales combines online site traffic monitoring software, with a sophisticated rules engine, to enable LivePerson clients to proactively engage website visitors. This engagement solution enables clients to maximize online revenue opportunities, improve conversion rates and reduce shopping cart abandonment by proactively engaging the right visitor, using the right channel, at the right time. Our solution identifies website visitors who demonstrate the highest propensity to convert, and engages them in real time with relevant content and offers, helping to generate incremental sales.

***LivePerson Enterprise for Service.*** LivePerson Enterprise for Service enables our customers to reduce costs in the contact center by identifying customers who may be struggling with their self-help experience, and proactively connecting them to a live customer care specialist. This comprehensive solution blends a proven value-based methodology with an active rules-based engagement engine and deep domain expertise to increase first contact resolution, improve customer satisfaction, and reduce attrition rates typically at a lower cost per interaction.

***LivePerson Enterprise Platinum.*** LivePerson Enterprise Platinum combines the capabilities of LivePerson Enterprise for Sales and Enterprise for Service solutions for very large, complex on-line businesses. Combining all of the functionality of these services, along with ability to support multiple lines of business, multiple geographies, and complex use-cases, the Platinum solution is the flagship offering for our largest clients.

***LivePerson Premier.*** With LivePerson Premier, midsize businesses with growing contact centers and moderate website traffic enjoy a comprehensive, flexible toolkit for visitor engagement. Advanced business rules capabilities include targeting for abandonment behavior, closing and upselling orders and boosting customer satisfaction, while maximizing agent productivity. Valuable insights into online sales initiatives and customer care issues are gained with informative real-time reports on conversion rates and abandonment.

***LivePerson Pro.*** LivePerson Pro enables small businesses (SMBs) with low site traffic and limited agent resources to increase online sales and improve customer service through a combination of live chat and real-time visitor monitoring tools. Using LivePerson Pro, chat agents are able to segment visitors and target the best candidates for a chat in real time. Integration with Google Analytics helps customers accurately measure the impact of the chat channel on their sales and conversion rates.

***LivePerson Expert Platform.*** LivePerson continues to maintain a marketplace platform where consumers can chat live with independent experts in a variety of categories. Personal advice has been one of the more popular and successful categories on the platform to date and we see potential in other categories such as counseling, programming and business advice. Affiliate marketing is a key component of our strategy to drive more consumer users to the platform, as is investment in search engine marketing (SEM) campaigns.

***Multichannel Contact Center Solutions.*** Adding LivePerson Voice, Email and Knowledgebase channels to LivePerson Pro or LivePerson Premier enables SMBs to further reduce service costs, deliver service consistency and

increase customer satisfaction by managing all communications from one easy-to-use environment.

**Professional Services.** The mission of our Professional Services team is to help customers optimize chat performance in order to drive incremental value through their online sales and/or service channel(s). This talented group utilizes their deep domain expertise and years of hands-on experience to provide customers with detailed analyses and measurements of their chat deployment that drive strategies and decisions on how to optimize the chat channel.

Deliverables of the team include scorecards that measure and chart performance

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trends, analyses and recommendations for web design and process improvement, transcript reviews to discover both voice of the customer insight and agent improvement opportunities, custom training of call center agents and management, and ongoing management of chat programs to ensure alignment with current business practices and objectives. The team's value-based methodology and approach to guiding customers towards chat channel optimization is an important component of the LivePerson offering, and gives our customers a competitive advantage in the online world.

## **Clients**

Our business operations client base includes Fortune 500 companies, dedicated Internet businesses, a broad range of online merchants, as well as numerous universities, libraries, government agencies and not-for-profit organizations. Our solutions benefit organizations of all sizes conducting business or communicating with customers online. We plan to continue to focus primarily on key target markets: financial services, retail, telecommunications, technology, and travel/hospitality industries, as well as the SMB sector, within the United States and Canada, Europe and the Asia-Pacific region.

No single customer accounted for or exceeded 10% of our total revenue in 2010.

## **Sales and Marketing**

### **Sales**

We sell our business products and services by leveraging a common methodology through both direct and indirect sales channels:

*Direct Sales.* Our sales process focuses on how our solutions and industry expertise deliver financial and operational value that support our clients' strategic initiatives. Our sales and marketing-focused solutions are targeted at business executives whose primary responsibility is maximizing online customer acquisition. These executives have a vested interest in improving conversion rates, increasing application completion rates and increasing average order value, as well as enhancing customer satisfaction. The value proposition for our customer service focused-solutions appeals to professionals who hold both top and bottom line responsibility for customer service and technical support functions within their organization, as well as enhancing customer satisfaction. Our proactive service solution enables these organizations to provide effective customer service by deflecting costly phone calls and emails to the more cost efficient chat channel. Whether we engage with individuals or teams responsible for online sales or service, LivePerson supports any organization with a company-wide strategic initiative to improve the overall online customer experience. Our sales methodology often begins with research and discovery meetings that enable us to develop a deep understanding of the value drivers and key performance metrics of a prospective client. We then present an analytical review detailing how our solutions and industry expertise can affect these value drivers and metrics. Once we validate solution capabilities and prove financial return on investment (ROI), we transition to a program management model wherein we work hand-in-hand with the client, providing detailed analyses, measurements and recommendations that help optimize their chat channel performance and ensure ongoing program success.

*Indirect Sales.* Resources within our organization are focused on developing partnerships to generate revenues via referral partnerships and indirect sales particularly as an adjunct to our SMB sales. By maximizing market coverage via partners who provide lead referrals and complementary products and services, we believe this channel supports revenue opportunities without incurring the costs associated with traditional direct sales.

## **Client Support**

Our Professional Services group provides deployment support and ongoing business consulting to enterprise and midmarket clients and maintains involvement throughout the engagement lifecycle. All LivePerson clients have access to 24/7 help desk services through chat, email and phone.

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### **Marketing**

Our marketing efforts in support of our business operations are organized around the needs, trends and characteristics of our existing and prospective client base. Our deep relationship with existing clients fosters continuous feedback, thereby allowing us to develop and refine marketing programs for specific industry segments. We market our products and services to executives responsible for the online channel and customer service operations of their organization.

Our primary focus is on the financial services, retail, telecommunications, technology, and travel/hospitality industries, as well as SMBs. Our integrated marketing strategy includes personalized lead generation campaigns to reach potential and existing clients using mediums such as paid and organic search, direct email and mail, industry- and category-specific tradeshows and events, and telemarketing.

Our marketing efforts in support of our consumer operations are focused on generating increased traffic to the LivePerson website primarily through paid and organic search, affiliate programs, display advertising and direct email. We are continually developing relationships with online publishers whose audiences have an affinity towards the services offered by our experts. By providing our experts with tools to self-promote their live advice services on LivePerson through blogs and social media, we also receive qualified traffic through these channels. We also work to maximize the rate of conversion of this traffic into either paying users or active experts.

Our marketing strategy also encompasses public relations. As a result of relationships developed with the media and industry analyst community, we gain positive media and editorial coverage. Other initiatives include securing public speaking opportunities, case studies and bylined articles featuring key executives and customers, which helps raise LivePerson's profile and reinforces our position as an industry leader. We also proactively facilitate formal and informal interaction among our most accomplished customers, enabling us to expand our role as one of their key strategic partners.

### **Competition**

The markets for online engagement technology and online consumer services are intensely competitive and characterized by aggressive marketing, evolving industry standards, rapid technology developments, and frequent new product introductions. LivePerson's business solutions compete directly with companies that facilitate real-time sales, email management, searchable knowledgebase applications and customer service interaction. These markets remain fairly saturated with small companies that compete on price and features. LivePerson faces competition from online interaction solution providers, including SaaS providers such as Art Technology Group (recently acquired by Oracle Corporation), RightNow Technologies, Talisma and TouchCommerce. We believe that our long-standing relationships with clients, particularly at the enterprise level, and our online selling expertise, including knowledge of online consumer purchasing habits, sophisticated methodologies to efficiently engage online consumers and reporting capabilities that measure return on investment differentiate us from existing competitors. We believe that as the scope, size and sophistication of our customers' requirements increases, our competitors' relative strengths as compared to our offerings declines. We face potential competition from Web analytics and online marketing service providers, such as Adobe and Google. We also face potential competition from larger enterprise software companies such as Oracle and SAP. In addition, established technology and/or consumer-oriented companies such as Google, Microsoft, Salesforce.com and Yahoo! may leverage their existing relationships and capabilities to offer online engagement solutions that facilitate real-time assistance and/or live advice. The most significant challenges facing any new market entrant include the ability to design and build scalable software that can support the world's most highly-trafficked websites, and, with respect to outsourced solution providers, the ability to design, build and manage a highly secure and scalable network infrastructure.

LivePerson's consumer operations compete with companies that provide cross category advice such as About.com and Yahoo Answers. The consumer operations also compete with niche players offering advice in specific vertical categories.

Finally, LivePerson competes with in-house online engagement solutions, as well as, to a lesser extent, traditional offline customer service solutions, such as telephone call centers.

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LivePerson believes that competition will increase as our current competitors increase the sophistication of their offerings and as new participants enter the market. Compared to LivePerson, some of our larger current and potential competitors may have:

stronger brand recognition;  
a wider range of products and services; and  
greater financial, marketing and research and development resources.

Additionally, some competitors may enter into strategic or commercial relationships with larger, more established and better-financed companies, enabling them to:

undertake more extensive marketing campaigns;  
adopt more aggressive pricing policies; and  
make more attractive offers to businesses to induce them to use their products or services.

Any change in the general market acceptance of the real-time sales, marketing and customer service solution business model or in online, real-time consumer advice services may harm our competitive position. Such changes may allow our competitors additional time to improve their service or product offerings, and would also provide time for new competitors to develop real-time sales, marketing, customer service and Web analytics applications or competitive consumer service offerings and solicit prospective clients within our target markets. Increased competition could result in pricing pressure, reduced operating margins and loss of market share.

## Technology

Three key technological features distinguish the LivePerson services:

We support our clients through a secure, scalable server infrastructure. In North America, our primary servers are hosted in a fully-secured, top-tier, third-party server center located in the Mid-Atlantic United States, and are supported by a top-tier backup server facility located in the Western United States. In Europe, our primary servers are hosted in a fully-secured, top-tier, third-party server center located in the United Kingdom and are supported by a top-tier backup server facility located in The Netherlands. Nearly all of our larger customers outside of the United States are hosted within our UK-based hosting facility.

To meet the growing demands of our expanding customer base, LivePerson transitioned its primary U.S. production facility to a co-located datacenter in early 2008, and its primary European production facility to a co-located datacenter in mid-2010. By managing our servers directly, we now have greater flexibility and control over the production environment, allowing us to be more responsive to customer needs and to continue to provide a superior level of service. Our network, hardware and software are designed to accommodate our clients' demand for secure, high-quality 24-hour per day/seven-day per week service.

As a hosted service, we are able to add additional capacity and new features quickly and efficiently. This has enabled us to provide these benefits simultaneously to our entire client base. In addition, it allows us to maintain a relatively short development and implementation cycle.

As a SaaS provider, we focus on the development of tightly integrated software design and network architecture. We dedicate significant resources to designing our software and network architecture based on the fundamental principles of security, reliability and scalability.

**Software Design.** Our software design is based on client-server architecture. As a SaaS provider, our clients install only the LivePerson Agent Console (Windows or Java-based) on their operators' workstations. Visitors to our clients' websites require only a standard Web browser and do not need to download software from LivePerson in order to interact with our clients' operators or to use the LivePerson services.



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Our software design is also based on open standards. These standard protocols facilitate integration with our clients legacy and third-party systems. Representative examples include:

Java

XML (Extensible Mark-up Language)

HTML (Hypertext Mark-up Language)

SQL (Structured Query Language)

HTTP (Hypertext Transfer Protocol)

**Network Architecture.** The software underlying our services is integrated with scalable and reliable network architecture. Our network is scalable; we do not need to add new hardware or network capacity for each new LivePerson client. This network architecture is hosted in collocation facilities with redundant network connections, servers and other infrastructure, enabling superior availability. Our backup server infrastructure housed at separate locations provides our primary hosting facilities with effective disaster recovery capability. For increased security, we use advanced firewall architecture and industry leading encryption standards. We also enable our clients to further encrypt their sensitive data using more advanced encryption algorithms.

## **Government Regulation**

We are subject to a number of foreign and domestic laws and regulations that apply to the conduct of business on the Internet and the management of customer and consumer data such as, but not limited to, laws and regulations relating to user privacy, freedom of expression, data privacy, content and quality of products and services, taxation, advertising, information security and intellectual property rights. We post on our website our privacy policies and practices concerning the use and disclosure of user data, and we observe data security protocols and other business practices to comply with applicable laws. Interpretation of user privacy and data protection laws, and their application to the Internet in the U.S. and foreign jurisdictions is ongoing. There is a risk that these laws may be interpreted and applied differently in any given jurisdiction in a manner that is not consistent with our current practices, which could cause us to incur substantial costs and otherwise negatively impact our business.

Various U.S. and foreign jurisdictions impose laws regarding the collection of data. Some U.S. states have enacted legislation designed to protect consumers' privacy by prohibiting the distribution of spyware over the Internet. Such legislation typically focuses on restricting the proliferation of software that, when installed on an end user's computer is used to intentionally and deceptively take control of the end user's machine. We do not believe that the data monitoring methods employed by our technology constitute spyware or that our data monitoring methods are prohibited by applicable laws. If the scope of this type of legislation were changed to include Web analytics, such legislation could be deemed to apply to the technology we use and could potentially restrict our ability to conduct our business.

Domestic and foreign governments are also considering restricting the collection and use of Internet visitor data generally. Some jurisdictions are considering whether the collection of even anonymous data may invade the privacy of Web site visitors. If laws that limit data collection practices are enacted, we and/or our customers may be required to obtain the express consent of web visitors in order for our technology to perform certain of its basic functions that are based on collection of data. Requirements that a website must first obtain consent from its Web visitors before using our technology could reduce the amount and value of the services we provide to customers, which might impede sales and/or cause some existing customers to discontinue using our services. We could also need to expend considerable effort and resources to develop new product features and/or procedures to comply with any such legal requirements.

Businesses using our products may collect personal information from their web users when those web users contact them with inquiries. Federal, state and foreign government bodies and agencies, however, have adopted and are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers. When required, we use a variety of data security procedures and practices such as encryption and masking algorithms to comply with applicable regulations, and encourage our customers to do the same. Changes to applicable laws and or interpretation thereof could

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significantly increase the economic burden to us of such compliance, and could negatively impact our business. The European Union and many countries within the European Union have adopted privacy directives or have imposed restrictions on the collection and use of data that are far more stringent, and impose more substantial burdens on subject businesses than current privacy standards in the United States. The U.S. federal Trade Commission has also taken action against website operators who do not comply with their stated privacy policies. All of these domestic and international legislative and regulatory initiatives have the potential to adversely affect our clients' ability to use our products.

A range of other proposed or existing laws and new interpretations of existing laws could have an impact on our business. For example:

proposed regulations regarding monitoring of online behavioral data such as the proposed Do Not Track regulations could potentially apply to some of our current or planned products and services. While there are currently many proposals by lawmakers and industry in this area, and several of those proposals, if adopted, would not be expected to materially impact our business, this is an evolving and unsettled area of regulation and any new significant restrictions or technological requirements imposed could have a negative impact on our business.

the Digital Millennium Copyright Act has provisions that limit, but do not necessarily eliminate, our liability for third-party content delivered through our website and products. In the U.S., laws relating to the liability of providers of online services for activities of their users and other third parties are currently being tested and could change. Certain foreign jurisdictions are also testing the liability of providers of online services for activities of their users and other third parties. While providers of online services currently are generally not held liable for activities of their third party users, changes in applicable laws imposing liability on providers of online services for activities of their users and other third parties could harm our business;

the Child Online Protection Act and the Children's Online Privacy Protection Act restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from children under 13. Today, our policies limit use of our consumer-facing site to adults over 18 years of age; and

the federal Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, or CAN-SPAM Act, regulates the transmission and content of commercial emails and, among other things, obligates the sender of such emails to provide recipients with the ability to opt-out of receiving future emails from the sender, and establishes penalties for the transmission of email messages which are intended to deceive the recipient as to source or content. Many state legislatures also have adopted laws that impact the delivery of commercial email, and laws that regulate commercial email practices have been enacted in some of the international jurisdictions in which we do business. In addition, Internet service providers and licensors of software products have introduced a variety of systems and products to filter out certain types of commercial email, without any common protocol to determine whether the recipient desired to receive the email being blocked. As a result, it is difficult for us to determine in advance whether or not emails generated by our clients using our solutions will be permitted by spam filters to reach the intended recipients.

In addition, because our services are accessible worldwide, certain foreign jurisdictions have claimed, and others may claim, that we are required to comply with their laws, even if we don't have a local entity, employees or infrastructure.

## **Intellectual Property and Proprietary Rights**

We rely on a combination of patent, copyright, trade secret, trademark and other common law in the United States and other jurisdictions, as well as confidentiality procedures and contractual provisions, to protect our proprietary technology, processes and other intellectual property. However, we believe that factors such as the technological and creative skills of our personnel, new service developments, frequent enhancements and reliable maintenance are more

essential to establishing and maintaining a competitive advantage. Others may develop technologies that are similar or superior to our technology. We enter into confidentiality and other written agreements with our employees, consultants, clients, potential clients and

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strategic partners, and through these and other written agreements, we attempt to control access to and distribution of our software, documentation and other proprietary information. Despite our efforts to protect our proprietary rights, third parties may, in an unauthorized manner, attempt to use, copy or otherwise obtain and market or distribute our intellectual property rights or technology or otherwise develop a service with the same functionality as our services. Policing unauthorized use of our services and intellectual property rights is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology or intellectual property rights, particularly in foreign countries where we do business, where our services are sold or used, where the laws may not protect proprietary rights as fully as do the laws of the United States or where enforcement of laws protecting proprietary rights is not common or effective.

Substantial litigation regarding intellectual property rights exists in the software industry. In the ordinary course of our business, our services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of services in different industry segments overlaps. Some of our competitors in the market for real-time sales, marketing and customer service solutions or other third parties may have filed or may intend to file patent applications covering aspects of their technology. Any claims alleging infringement of third-party intellectual property rights could require us to spend significant amounts in litigation (even if the claim is invalid), distract management from other tasks of operating our business, pay substantial damage awards, prevent us from selling our products, delay delivery of the LivePerson services, develop non-infringing software, technology, business processes, systems or other intellectual property (none of which might be successful), or limit our ability to use the intellectual property that is the subject of any of these claims, unless we enter into license agreements with the third parties (which may be costly, unavailable on commercially reasonable terms, or not available at all). Therefore, such claims could have a material adverse effect on our business, results of operations and financial condition.

## **Employees**

As of March 1, 2011, we had 481 full-time employees. Our employees are not covered by collective bargaining agreements. We believe our relations with our employees are satisfactory.

## **Website Access to Reports**

We make available, free of charge, on our website (*www.liveperson.com*), our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we have electronically filed such material with, or furnished it to, the Securities and Exchange Commission. *The Company's web site address provided above is not intended to function as a hyperlink, and the information on the Company's web site is not and should not be considered part of this Annual Report on Form 10-K and is not incorporated by reference herein.*

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## Item 1A. Risk Factors

The following are certain of the important risk factors that could cause, or contribute to causing, our actual operating results to differ materially from those indicated, expected or suggested by forward-looking statements made in this Annual Report on Form 10-K or presented elsewhere by management from time to time. The risks described below are not the only ones we face. Additional risks not presently known to us, or that we currently deem immaterial, may become important factors that impair our business operations. Prospective and existing investors are strongly urged to carefully consider the various cautionary statements and risks set forth in this report and other public filings before deciding to purchase, hold or sell our common stock.

### Risks Related to Our Business

#### **Our quarterly revenue and operating results may be subject to significant fluctuations, which may adversely affect the trading price of our common stock.**

Although we achieved profitability in 2010, we may in the future incur losses and experience negative cash flow, either or both of which may be significant and may cause our quarterly revenue and operating results to fluctuate significantly. These fluctuations may be as a result of a variety of factors, including the following factors which are in part within our control, and in part outside of our control:

continued adoption by companies doing business online of real-time sales, marketing and customer service solutions;  
continued adoption by individual experts and consumers of online real-time advice services;  
changes in our pricing models, policies or the pricing policies of our current and future competitors;  
our clients' business success;  
our clients' demand for our services;  
consumer demand for our services;  
our ability to attract and retain clients;  
the amount and timing of capital expenditures and other costs relating to the expansion of our operations, including those related to acquisitions; and  
the introduction of new services by us or our competitors.

Our revenue and results may also fluctuate significantly in the future due to the following factors that are entirely outside of our control:

economic conditions specific to the Internet, electronic commerce and online media; and  
general economic and political conditions.

Period-to-period comparisons of our operating results may not be meaningful because of these factors. You should not rely upon these comparisons as indicators of our future performance.

Due to the foregoing factors, it is possible that our results of operations in one or more future quarters may fall below the expectations of securities analysts and investors. If this occurs, the trading price of our common stock could decline.

**The ongoing global economic downturn that began in 2008 may adversely affect our business and results of operations.**

The U.S. and other global economies have continued to experience an economic downturn that has affected all sectors of the economy, particularly in the financial services and retail industries, resulting in declines in economic growth and consumer confidence, increases in unemployment rates and uncertainty about economic stability. Global credit and financial markets have also experienced extreme disruptions, including diminished liquidity and credit availability and rapid fluctuations in market valuations. Our business has been affected by these conditions, and there is no certainty that economic conditions will not deteriorate further.

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These uncertainties affect businesses such as ours in a number of ways, making it difficult to accurately forecast and plan our future business activities.

Weak economic conditions may also cause our clients to experience difficulty in supporting their current operations and implementing their business plans. Our clients may reduce their spending on our services, may not be able to discharge their payment and other obligations to us, may experience difficulty raising capital, or may elect to scale back the resources they devote to customer service and/or sales and marketing technology, including services such as ours. The economic condition may also lead consumers and businesses to continue to postpone spending, which may cause our clients to decrease or delay their purchases of our products and services. If the current economic conditions continue or further deteriorate for us or our clients, we could be required to record charges relating to restructuring costs or the impairment of assets, may not be able to collect receivables on a timely basis, and our business, financial condition and results of operations could be materially adversely affected.

**If we are not competitive in the markets for online sales, marketing and customer service solutions, or online consumer services, our business could be harmed.**

The markets for online engagement technology and online consumer services are intensely competitive and characterized by aggressive marketing, evolving industry standards, rapid technology developments and frequent new product introductions. Established or new entities may enter the market in the near future, including those that provide solutions for real-time interaction online, or online consumer services related to real-time advice.

We compete directly with companies focused on technology that facilitates real-time sales, email management, searchable knowledgebase applications and customer service interaction. These markets remain fairly saturated with small companies that compete on price and features. We face significant competition from online interaction solution providers, including SaaS providers such as Art Technology Group (recently acquired by Oracle Corporation), RightNow Technologies, Talisma and TouchCommerce. We face potential competition from Web analytics and online marketing service providers, such as Adobe and Google. We also face potential competition from larger enterprise software companies such as Oracle and SAP. In addition, established technology companies such as Google, Microsoft, Salesforce.com and Yahoo may leverage their existing relationships and capabilities to offer online engagement solutions that facilitate real-time assistance and live advice.

Furthermore, many of our competitors offer a broader range of customer relationship management products and services than we currently offer. We may be disadvantaged and our business may be harmed if companies doing business online choose real-time sales, marketing and customer service solutions from such providers.

Finally, we compete with clients and potential clients that choose to provide a real-time sales, marketing and customer service solution in-house as well as, to a lesser extent, traditional offline customer service solutions, such as telephone call centers.

We believe that competition will increase as our current competitors increase the sophistication of their offerings and as new participants enter the market. As compared to our company, some of our larger current and potential competitors have:

greater brand recognition;  
more diversified lines of products and services; and  
significantly greater financial, marketing and research and development resources.

If we are not competitive in the markets for online sales, marketing and customer service solutions, or online consumer

Additionally, some competitors may enter into strategic or commercial relationships with larger, more established and better-financed companies. These competitors may be able to:

undertake more extensive marketing campaigns;  
adopt more aggressive pricing policies; and

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make more attractive offers to businesses or individuals to induce them to use their products or services. Any change in the general market acceptance of the real-time sales, marketing and customer service solution business model or in online, real-time consumer advice services may harm our competitive position. Such changes may allow our competitors additional time to improve their service or product offerings, and would also provide time for new competitors to develop real-time sales, marketing, customer service and Web analytics applications or competitive consumer service offerings and solicit prospective clients within our target markets. Increased competition could result in pricing pressures, reduced operating margins and loss of market share.

**The success of our business is dependent on the retention of existing clients and their purchase of additional services, as well as attracting new customers and consumer users to our consumer services.**

Our business services agreements typically have twelve month terms. In some cases, our agreements are terminable or may terminate upon 30 to 90 days notice without penalty. If a significant number of our clients, or any one client to whom we provide a significant amount of services, were to terminate services, or reduce the amount of services purchased or fail to purchase additional services, our results of operations may be negatively and materially affected. Dissatisfaction with the nature or quality of our services could also lead clients to terminate our service. We depend on monthly fees and interaction-based fees from our services for substantially all of our revenue. If our retention rate declines, our revenue could decline unless we are able to obtain additional clients or alternate revenue sources. Because of the historically small amount of services sold in initial orders, we depend on the growth of our customer base and sales to new clients and sales of additional services to our existing clients.

**New and developing regulatory or other legal requirements could materially impact our business.**

We, and our customers, are subject to a number of foreign and domestic laws and regulations that apply to the conduct of business on the Internet such as, but not limited to, laws and regulations relating to user privacy, data privacy, content, advertising, information security and intellectual property rights. We post on our web site our privacy policies and practices concerning the use and disclosure of user data, and we observe data security protocols and other business practices to comply with applicable laws. Interpretation of user privacy and data protection laws, and their application to the Internet in the U.S. and foreign jurisdictions is ongoing. There is a risk that these laws may be interpreted and applied differently in any given jurisdiction in a manner that is not consistent with our current practices, which could cause us to incur substantial costs and otherwise negatively impact our business.

Various U.S. and foreign jurisdictions impose laws regarding the collection of data. Some U.S. states have enacted legislation designed to protect consumers privacy by prohibiting the distribution of spyware over the Internet. Such legislation typically focuses on restricting the proliferation of software that, when installed on an end user s computer is used to intentionally and deceptively take control of the end user s machine. We do not believe that the data monitoring methods employed by our technology constitute spyware or that our data monitoring methods are prohibited by applicable laws. If the scope of this type of legislation were changed to include Web analytics, such legislation could be deemed to apply to the technology we use and could potentially restrict our ability to conduct our business.

Domestic and foreign governments are also considering restricting the collection and use of Internet visitor data generally. Some jurisdictions are considering whether the collection of even anonymous data may invade the privacy of Web site visitors. If laws that limit data collection practices are enacted, we and/or our customers may be required

to obtain the express consent of web visitors in order for our technology to perform certain of its basic functions that are based on collection of data. Requirements that a website must first obtain consent from its Web visitors before using our technology could reduce the amount and value of the services we provide to customers, which might impede sales and/or cause some existing customers to discontinue using our services. We could also need to expend considerable effort and resources to develop new product features and/or procedures to comply with any such legal requirements.

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Businesses using our products may collect personal information from their web users when those web users contact them with inquiries. Federal, state and foreign government bodies and agencies, however, have adopted and are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers. When required, we use a variety of data security procedures and practices such as encryption and masking algorithms to comply with applicable regulations, and encourage our customers to do the same. Changes to applicable laws and or interpretation thereof could significantly increase the economic burden to us of such compliance, and could negatively impact our business. European Union members have imposed restrictions on the collection and use of data that are far more stringent, and impose more substantial burdens on subject businesses than current privacy standards in the United States. All of these domestic and international legislative and regulatory initiatives have the potential to adversely affect our clients' ability to use our products.

Proposed regulations regarding monitoring of online behavioral data such as the proposed Do Not Track regulations could potentially apply to some of our current or planned products and services. While there are currently many proposals by lawmakers and industry in this area, and several of those proposals, if adopted, would not be expected to materially impact our business, this is an evolving and unsettled area of regulation and any new significant restrictions or technological requirements imposed could have a negative impact on our business.

The Digital Millennium Copyright Act has provisions that limit, but do not necessarily eliminate, our liability for third-party content delivered through our website and products. In the U.S., laws relating to the liability of providers of online services for activities of their users and other third parties are currently being tested and could change. Certain foreign jurisdictions are also testing the liability of providers of online services for activities of their users and other third parties. While providers of online services currently are generally not held liable for activities of their third party users, changes in applicable laws imposing liability on providers of online services for activities of their users and other third parties could harm our business.

The Child Online Protection Act and the Children's Online Privacy Protection Act restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from children under 13. Today, our policies limit use of our consumer-facing site to adults over 18 years of age.

In January 2004, the federal Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, or CAN-SPAM Act, became effective. The CAN-SPAM Act regulates the transmission and content of commercial emails and, among other things, obligates the sender of such emails to provide recipients with the ability to opt-out of receiving future emails from the sender, and establishes penalties for the transmission of email messages which are intended to deceive the recipient as to source or content. Many state legislatures also have adopted laws that impact the delivery of commercial email, and laws that regulate commercial email practices have been enacted in some of the international jurisdictions in which we do business. In addition, Internet service providers and licensors of software products have introduced a variety of systems and products to filter out certain types of commercial email, without any common protocol to determine whether the recipient desired to receive the email being blocked. As a result, it is difficult for us to determine in advance whether or not emails generated by our clients using our solutions will be permitted by spam filters to reach the intended recipients.

**If our goodwill becomes impaired, we may be required to record a charge to earnings.**

Under accounting principles generally accepted in the U.S., we review our goodwill for impairment at least annually and when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be



considered a change in circumstances indicating that the carrying value of our goodwill may not be recoverable include a decline in stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in our industry. In December 2008, we recorded a \$23.5 million impairment charge in connection with the Kasamba Inc. acquisition. From time to time, we may be required to record additional charges to earnings in our financial statements during the period in which any impairment of our goodwill is determined, which may negatively impacting our results of operations.

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**We are exposed to currency rate fluctuations and our results of operations may be affected as a result.**

Although the functional currency of our Israeli subsidiaries is the U.S. dollar, 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 has increased. In addition, the functional currency of our operations in the U.K. is the U.K. pound. Conducting business in currencies other than the U.S. dollar subjects us to fluctuations in currency exchange rates that could adversely affect our results of operations. Fluctuations in the value of the U.S. dollar relative to other foreign currencies affect our revenue, cost of revenue and operating expenses, and result in foreign currency transaction gains and losses. Currently, we are not a party to any hedging transactions intended to reduce our exposure to exchange rate fluctuations for our international operations. We may seek to enter into hedging transaction in the future, but we may be unable to enter into those transactions successfully, on acceptable terms or at all. We cannot predict whether or not we will incur foreign exchange losses in the future. To the extent the international component of our revenues grows, our results of operations will become more sensitive to foreign exchange rate fluctuations.

**We could face additional regulatory requirements, tax liabilities, currency exchange rate fluctuations and other risks as we expand internationally and/or as we expand into direct-to-consumer services.**

In October 2007, we acquired Kasamba Inc., an Israeli-based provider of a platform for online, real-time expert advice. In October 2000, we acquired HumanClick, an Israeli-based provider of real-time online customer service applications. In addition, we have established a sales, marketing and client support presence in the United Kingdom in support of expansion efforts into Western Europe, and have integrated the United Kingdom operations of Proficient Systems into that office. There are risks related to doing business in international markets as well as in the online consumer market, such as changes in regulatory requirements, tariffs and other trade barriers, fluctuations in currency exchange rates, more stringent rules relating to the privacy of Internet users and adverse tax consequences. In addition, there are likely to be different consumer preferences and requirements in specific international markets. Furthermore, we may face difficulties in staffing and managing any foreign operations. One or more of these factors could harm any future international operations.

**We may be unable to respond to the rapid technological change and changing client preferences in the online sales, marketing, customer service, and/or online consumer services industries and this may harm our business.**

If we are unable, for technological, legal, financial or other reasons, to adapt in a timely manner to changing market conditions in the online sales, marketing, customer service and/or e-commerce industry or our clients' or Internet users' requirements or preferences, our business, results of operations and financial condition would be materially and adversely affected. Business on the Internet is characterized by rapid technological change. In addition, the market for online sales, marketing, customer service and expert advice solutions is relatively new. Sudden changes in client and Internet user requirements and preferences, frequent new product and service introductions embodying new technologies, such as broadband communications, and the emergence of new industry standards and practices such as but not limited to security standards could render the LivePerson services and our proprietary technology and systems obsolete. The rapid evolution of these products and services will require that we continually improve the performance, features and reliability of our services. Our success will depend, in part, on our ability to:

enhance the features and performance of our services;

develop and offer new services that are valuable to companies doing business online as well as Internet users; and respond to technological advances and emerging industry standards and practices in a cost-effective and timely manner.

If any of our new services, including upgrades to our current services, do not meet our clients' or Internet users' expectations, our business may be harmed. Updating our technology may require significant additional capital expenditures and could materially and adversely affect our business, results of operations and financial condition.

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If new services require us to grow rapidly, this could place a significant strain on our managerial, operational, technical and financial resources. In order to manage our growth, we could be required to implement new or upgraded operating and financial systems, procedures and controls. Our failure to expand our operations in an efficient manner could cause our expenses to grow, our revenue to decline or grow more slowly than expected and could otherwise have a material adverse effect on our business, results of operations and financial condition.

**Our business is significantly dependent on our ability to retain our current key personnel, to attract new personnel, and to manage staff attrition.**

Our future success depends to a significant extent on the continued services of our senior management team. The loss of the services of any member of our senior management team could have a material and adverse effect on our business, results of operations and financial condition. We cannot assure you that we would be able to successfully recruit and integrate newly-hired senior managers who would work together successfully with our existing management team.

We may be unable to attract, integrate or retain other highly qualified employees in the future. If our retention efforts are ineffective, employee turnover could increase and our ability to provide services to our clients would be materially and adversely affected. Furthermore, the requirement to expense stock options may discourage us from granting the size or type of stock option awards that job candidates may require to join our company.

Any staff attrition we experience, whether initiated by the departing employees or by us, could place a significant strain on our managerial, operational, financial and other resources. To the extent that we do not initiate or seek any staff attrition that occurs, there can be no assurance that we will be able to identify and hire adequate replacement staff promptly, if at all, and even that if such staff is replaced, we will be successful in integrating these employees. In addition, we may not be able to outsource certain functions. We expect to evaluate our needs and the performance of our staff on a periodic basis, and may choose to make adjustments in the future. If the size of our staff is significantly reduced, either by our choice or otherwise, it may become more difficult for us to manage existing, or establish new, relationships with clients and other counter-parties, or to expand and improve our service offerings. It may also become more difficult for us to implement changes to our business plan or to respond promptly to opportunities in the marketplace. Further, it may become more difficult for us to devote personnel resources necessary to maintain or improve existing systems, including our financial and managerial controls, billing systems, reporting systems and procedures. Thus, any significant amount of staff attrition could cause our business and financial results to suffer.

**We may be unsuccessful in expanding our operations internationally, which could adversely affect our results of operations.**

During the past decade, we have completed acquisitions outside the United States. We have also continued to invest in expansion of operations in the United Kingdom, Europe, Israel and the Asia-Pacific region. Our ability to continue our international expansion involves various risks, including the possibility that returns on such investments will not be achieved in the near future, or ever, and the difficulty of competing in markets with which we are unfamiliar.

Our international operations may also fail due to other risks inherent in foreign operations, including:

varied, unfamiliar and unclear legal and regulatory restrictions, including different legal and regulatory standards applicable to Internet services, communications, privacy, and data protection;  
difficulties in staffing and managing foreign operations;  
differing intellectual property laws that may not provide sufficient protection for our intellectual property;

Our business is significantly dependent on our ability to retain our current key personnel, to attract new personnel, and to manage staff attrition.

adverse tax consequences;  
difficulty in addressing country-specific business requirements and regulations;  
fluctuations in currency exchange rates;

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strains on financial and other systems to properly administer VAT and other taxes; and legal, political or systemic restrictions on the ability of U.S. companies to do business in foreign countries. Our current and any future international expansion plans will require management attention and resources and may be unsuccessful. We may find it impossible or prohibitively expensive to continue expand internationally or we may be unsuccessful in our attempt to do so, and our results of operations could be adversely impacted.

**If we do not successfully integrate past or potential future acquisitions, our business could adversely impacted.**

We have made several acquisitions during the past decade. In April 2010, we acquired NuConomy Ltd., an Israeli-based development-stage company. In October 2007, we acquired Kasamba Inc., an Israeli-based provider of a platform for online, real-time expert advice. In July 2006, we acquired Proficient Systems, Inc., a U.S. provider of hosted proactive chat solutions that help companies generate revenue on their websites. In the future, we may acquire or invest in complementary companies, products or technologies. Acquisitions and investments involve numerous risks to us, including:

- difficulties in integrating operations, technologies, products and personnel with LivePerson;
- diversion of financial and management resources from efforts related to the LivePerson services or other pre-existing operations;
- risks of entering new markets beyond providing real-time sales, marketing and customer service solutions for companies doing business online;
- potential loss of either our existing key employees or key employees of any companies we acquire; and
- our inability to generate sufficient revenue following an acquisition to offset acquisition or investment costs.

These difficulties could disrupt our ongoing business, expose us to unexpected costs, distract our management and employees, increase our expenses and adversely affect our results of operations. Furthermore, we may incur debt or issue equity securities to pay for any future acquisitions. The issuance of equity securities could be dilutive to our existing stockholders.

**We are dependent on technology systems and third-party content that are beyond our control.**

The success of our services depends in part on our clients' online services as well as the Internet connections of visitors to websites, both of which are outside of our control. As a result, it may be difficult to identify the source of problems if they occur. In the past, we have experienced problems related to connectivity which has resulted in slower than normal response times to Internet user chat requests and messages and interruptions in service. Our services rely both on the Internet and on our connectivity vendors for data transmission. Therefore, even when connectivity problems are not caused by our services, our clients or Internet users may attribute the problem to us. This could diminish our brand and harm our business, divert the attention of our technical personnel from our product development efforts or cause significant client relations problems.

In addition, we rely in part on third-party service providers and other third parties for Internet connectivity and network infrastructure hosting, security and maintenance. These providers may experience problems that result in slower than normal response times and/or interruptions in service. If we are unable to continue utilizing the third-party services that support our Web hosting and infrastructure or if our services experience interruptions or delays due to third party providers, our reputation and business could be harmed.

We also depend on third parties for hardware and software and our consumer services depend on third parties for content. Such products and content could contain defects or inaccurate information. Problems arising from our use of such hardware or software or third party content could require us to incur significant costs or divert the attention of our technical or other personnel from our product development efforts or to

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manage issues related to content. To the extent any such problems require us to replace such hardware or software we may not be able to do so on acceptable terms, if at all.

**Privacy concerns relating to the Internet are increasing, which could result in new legislation, negative public perception and/or user behavior that negatively affect our business.**

We collect data from live online Internet user dialogues and enable our clients to capture and save information about their Internet user interactions. To the extent that additional legislation regarding Internet user privacy is enacted, such as legislation governing the collection and use of information regarding Internet users through the use of cookies, the effectiveness of the LivePerson services could be impaired by restricting us from collecting information which may be valuable to our clients. The foregoing could have a material adverse effect our business, results of operations and financial condition.

In addition, privacy concerns may cause Internet users to avoid online sites that collect such behavioral information and even the perception of security and privacy concerns, whether or not valid, may indirectly inhibit market acceptance of our services. In addition, we or our clients may be harmed by any laws or regulations that restrict the ability to collect, transmit or use this data. The European Union and many countries within the E.U. have adopted privacy directives or laws that strictly regulate the collection and use of personally identifiable information of Internet users. The United States has also adopted legislation which governs the collection and use of certain personal information, such as the Children's Online Privacy Protection Act which directs the U.S. Federal Trade Commission to regulate the collection of data from children on commercial websites. The U.S. Federal Trade Commission has also taken action against website operators who do not comply with their stated privacy policies. Furthermore, other foreign jurisdictions have adopted legislation governing the collection and use of personal information. These and other governmental efforts may limit our clients' ability to collect and use information about their interactions with their Internet users through our services. As a result, such laws and efforts could create uncertainty in the marketplace that could reduce demand for our services or increase the cost of doing business as a result of litigation costs or increased service delivery costs, or could in some other manner have a material adverse effect on our business, results of operations and financial condition.

**We may be liable if third parties misappropriate personal information belonging to our clients' Internet users.**

The dialogue transcripts of the text-based chats and email interactions between our clients and Internet users may include personal information, such as contact and demographic information. If third parties were able to penetrate our network security or otherwise misappropriate personal information relating to our clients' Internet users or the text of customer service inquiries, we could be subject to liability. We could be subject to negligence claims or claims for misuse of personal information. These claims could result in litigation, which could have a material adverse effect on our business, results of operations and financial condition. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by such breaches. The need to physically secure and securely transmit confidential information online has been a significant barrier to e-commerce and online communications. Any well-publicized compromise of security could deter people from using online services such as the ones we offer or from using them to conduct transactions, which involve transmitting confidential information. Because our success depends on the general acceptance of our services and electronic commerce, we may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by these breaches.



**We may be subject to legal liability and/or negative publicity for the services provided to consumers via our technology platforms.**

Our technology platforms enable representatives of our clients as well as individual service providers to communicate with consumers and other persons seeking information or advice on the Internet. The law relating to the liability of online platform providers such as us for the activities of users of their online platforms is often challenged in the U.S. and internationally. We may be unable to prevent users of our technology platforms from providing negligent, unlawful or inappropriate advice, information or content via our technology platforms, or from behaving in an unlawful manner, and we may be subject to allegations of civil or criminal liability for negligent, fraudulent, unlawful or inappropriate activities carried out by users of our technology platforms.

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Claims could be made against online services companies under both U.S. and foreign law such as fraud, defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated by users of our technology platforms. In addition, domestic and foreign legislation has been proposed that could prohibit or impose liability for the transmission over the Internet of certain types of information. Our defense of any of these actions could be costly and involve significant time and attention of our management and other resources.

The Digital Millennium Copyright Act, or DMCA, is intended, among other things, to reduce the liability of online service providers for listing or linking to third party Web properties that include materials that infringe copyrights or rights of others. Additionally, portions of The Communications Decency Act, or CDA, are intended to provide statutory protections to online service providers who distribute third party content. A safe harbor for copyright infringement is also available under the DMCA to certain online service providers that provide specific services, if the providers take certain affirmative steps as set forth in the DMCA. Important questions regarding the safe harbor under the DMCA and the CDA have yet to be litigated, and we cannot guarantee that we will meet the safe harbor requirements of the DMCA or of the CDA. If we are not covered by a safe harbor, for any reason, we could be exposed to claims, which could be costly and time-consuming to defend.

Our consumer service allows consumers to provide feedback regarding service providers. Although all such feedback is generated by users and not by us, claims of defamation or other injury could be made against us for content posted on our websites. Our liability for such claims may be higher in jurisdictions outside the U.S. where laws governing Internet transactions are unsettled.

If we become liable for information provided by our users and carried via our service in any jurisdiction in which we operate, we could be directly harmed and we may be forced to implement new measures to reduce our exposure to this liability. In addition, the increased attention focused upon liability issues as a result of these lawsuits and legislative proposals could harm our reputation or otherwise impact the growth of our business. Any costs incurred as a result of this potential liability could harm our business.

In addition, negative publicity and user sentiment generated as a result of fraudulent or deceptive conduct by users of our technology platforms could damage our reputation, reduce our ability to attract new users or retain our current users, and diminish the value of our brand.

In the future, we may be required to spend substantial resources to take additional protective measures or discontinue certain service offerings, either of which could harm our business. Any costs incurred as a result of potential liability relating to the sale of unlawful services or the unlawful sale of services could harm our business.

In addition to privacy legislation, any new legislation or regulation regarding the Internet, software sales or export and/or the Software-as-a-Service industry, and/or the application of existing laws and regulations to the Internet, software sales or export, and/or the Software-as-a-Service industry could create new legal or regulatory burdens on our business that could have a material adverse effect on our business, results of operations and financial condition. Additionally, as we operate outside the U.S., the international regulatory environment relating to the Internet, software sales or export, and/or the Software-as-a-Service industry could have a material adverse effect on our business, results of operations and financial condition.

**Our products and services may infringe upon intellectual property rights of third parties and any infringement could require us to incur substantial costs and may distract our management.**

Our products and services may infringe upon intellectual property rights of third parties and any infringement could

We are subject to the risk of claims alleging infringement of third-party proprietary rights. Substantial litigation regarding intellectual property rights exists in the software industry. In the ordinary course of our business, our services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of services in different industry segments overlaps. Some of our competitors in the market for real-time sales, marketing and customer service solutions or other third parties may have filed or may intend to file patent applications covering aspects of their technology. Any claims alleging infringement of third-party intellectual property rights could require us to spend significant amounts in litigation (even if the claim is invalid), distract management from other tasks of operating our business, pay substantial damage awards, prevent us from selling our products, delay delivery of

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the LivePerson services, develop non-infringing software, technology, business processes, systems or other intellectual property (none of which might be successful), or limit our ability to use the intellectual property that is the subject of any of these claims, unless we enter into license agreements with the third parties (which may be costly, unavailable on commercially reasonable terms, or not available at all). Therefore, such claims could have a material adverse effect on our business, results of operations and financial condition.

**Our business and prospects would suffer if we are unable to protect and enforce our intellectual property rights.**

Our success and ability to compete depend, in part, upon the protection of our intellectual property rights relating to the technology underlying the LivePerson services. It is possible that:

any issued patent or patents issued in the future may not be broad enough to protect our intellectual property rights; any issued patent or any patents issued in the future could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in the patents; current and future competitors may independently develop similar technologies, duplicate our services or design around any patents we have; and

effective patent protection may not be available in every country in which we do business, where our services are sold or used, where the laws may not protect proprietary rights as fully as do the laws of the U.S. or where enforcement of laws protecting proprietary rights is not common or effective.

Further, to the extent that the invention described in any U.S. patent was made public prior to the filing of the patent application, we may not be able to obtain patent protection in certain foreign countries. We also rely upon copyright, trade secret, trademark and other common law in the U.S. and other jurisdictions, as well as confidentiality procedures and contractual provisions, to protect our proprietary technology, processes and other intellectual property. Any steps we might take may not be adequate to protect against infringement and misappropriation of our intellectual property by third parties. Similarly, third parties may be able to independently develop similar or superior technology, processes or other intellectual property. Policing unauthorized use of our services and intellectual property rights is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology or intellectual property rights, particularly in foreign countries where we do business, where our services are sold or used, where the laws may not protect proprietary rights as fully as do the laws of the United States or where enforcement of laws protecting proprietary rights is not common or effective. The unauthorized reproduction or other misappropriation of our intellectual property rights could enable third parties to benefit from our technology without paying us for it. If this occurs, our business, results of operations and financial condition could be materially and adversely affected. In addition, disputes concerning the ownership or rights to use intellectual property could be costly and time-consuming to litigate, may distract management from operating our business and may result in our loss of significant rights.

**Technological or other defects could disrupt or negatively impact our services, which could harm our business and reputation.**

We face risks related to the technological capabilities of our services. We expect the number of interactions between our clients operators and Internet users over our system to increase significantly as we expand our client base. Our network hardware and software may not be able to accommodate this additional volume. Additionally, we must continually upgrade our software to improve the features and functionality of our services in order to be competitive in our markets. If future versions of our software contain undetected errors, our business could be harmed. If third-party content is flawed, our business could be harmed. As a result of major software upgrades at LivePerson, our client sites have, from time to time, experienced slower than normal response times and interruptions in service. If we

Our business and prospects would suffer if we are unable to protect and enforce our intellectual property rights.

experience system failures or degraded response times, our reputation and brand could be harmed. We may also experience technical problems in the process of installing and initiating the LivePerson services on new Web hosting services. These problems, if not remedied, could harm our business.

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Our services also depend on complex software which may contain defects, particularly when we introduce new versions onto our servers. We may not discover software defects that affect our new or current services or enhancements until after they are deployed. It is possible that, despite testing by us, defects may occur in the software. These defects could result in:

damage to our reputation;  
lost sales;  
delays in or loss of market acceptance of our products; and  
unexpected expenses and diversion of resources to remedy errors.

**The non-payment or late payment of amounts due to us from a significant number of clients may negatively impact our financial condition or make it difficult to forecast our revenues accurately.**

During 2010, we increased our allowance for doubtful accounts by \$166,000 to approximately \$561,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. During 2009, we increased our allowance for doubtful accounts by \$68,000 to approximately \$408,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. We wrote off approximately \$13,000 of previously reserved accounts, leaving a net allowance for doubtful accounts of \$395,000. As a result of increasingly long payment cycles, we have faced increased difficulty in predicting our operating results for any given period, and have experienced significant unanticipated fluctuations in our revenues from period to period. Any failure to achieve anticipated revenues in a period could cause our stock price to decline.

**Our services are subject to payment-related risks.**

For certain payment methods, including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs and lower our profit margins. We rely on third parties to provide payment processing services, including the processing of credit cards, debit cards and it could disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers or facilitate other types of online payments, and our business and operating results could be adversely affected.

Through our consumer-facing platform, we facilitate online transactions between individual service providers who provide online advice and information to consumers. In connection with these services, we accept payments using a variety of methods, such as credit card, debit card and PayPal. These payments are subject to chargebacks when consumers dispute payments they have made to us. Chargebacks can occur whether or not services were properly provided. Susceptibility to chargebacks puts a portion of our revenue at risk. We take measures to manage our risk relative to chargebacks and to recoup properly charged fees, however, if we are unable to successfully manage this risk our business and operating results could be adversely affected. As we offer new payment options to our users, we may be subject to additional regulations, compliance requirements, and fraud.

We are also subject to a number of other laws and regulations relating to money laundering, international money transfers, privacy and information security and electronic fund transfers. If we were found to be in violation of

The non-payment or late payment of amounts due to us from a significant number of clients may negatively impact

applicable laws or regulations, we could be subject to civil and criminal penalties or forced to cease our payments services business.

**We have a history of losses, we had an accumulated deficit of \$100.2 million as of December 31, 2010 and we may incur losses in the future.**

Although we achieved profitability in 2010, we may, in the future, incur losses and experience negative cash flow, either or both of which may be significant. We recorded net losses from inception through the year ended December 31, 2003. We recorded net income for the years ended December 31, 2004 through 2007 and

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in 2009 and 2010. We recorded a net loss of \$23.8 million for the year ended December 31, 2008. As of December 31, 2010, our accumulated deficit was approximately \$100.2 million. We cannot assure you that we can sustain or increase profitability on a quarterly or annual basis in the future. Failure to maintain profitability may materially and adversely affect the market price of our common stock.

**With the recent volatility in the capital markets, there is a risk that we could suffer a loss of principal in our cash and cash equivalents and short term investments and suffer a reduction in our interest income or in our return on investments.**

As of December 31, 2010, we had \$61.3 million in cash and cash equivalents. We regularly invest excess funds from our cash and cash equivalents in short-term money market funds. We currently hold no mortgaged-backed or auction rate securities. However, some of our investments are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by the ongoing uncertainty in the U.S. and global credit markets that have affected various sectors of the financial markets and caused global credit and liquidity issues. In the future, these market risks associated with our investment portfolio may harm the results of our operations, liquidity and financial condition. Although we believe we have chosen a more cautious portfolio designed to preserve our existing cash position, it may not adequately protect the value of our investments. Furthermore, this more cautious portfolio is unlikely to provide us with any significant interest income in the near term.

**We cannot assure our stockholders that our current or future stock repurchase programs will enhance/has enhanced long-term stockholder value and stock repurchases could increase the volatility of the price of our common stock and will diminish our cash reserves.**

On May 14, 2010, our Board of Directors approved a stock repurchase program through June 30, 2012. Under the 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 them depending upon prevailing market conditions and other corporate considerations, up to an aggregate purchase price of \$10.0 million. The timing and actual number of shares repurchased depend on a variety of factors including the timing of open trading windows, price, corporate and regulatory requirements, and other market conditions. The program may be suspended or discontinued at any time without prior notice. Repurchases pursuant to our stock repurchase program could affect our stock price and increase its volatility. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, our stock repurchase program will diminish our cash reserves, which could impact our ability to pursue possible future strategic opportunities and acquisitions and could result in lower overall returns on our cash balances. There can be no assurance that any stock repurchases will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased shares of stock. Although our stock repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program's effectiveness. As of March 1, 2011, approximately \$6.4 million remained available for purchases under the program.

**Failure to license necessary third party software for use in our products and services, or failure to successfully integrate third party software, could cause delays or reductions in our sales, or errors or failures of our service.**

We have a history of losses, we had an accumulated deficit of \$100.2 million as of December 31, 2010 and we may



We license third party software that we plan to incorporate into our products and services. In the future, we might need to license other software to enhance our products and meet evolving customer requirements. These licenses may not continue to be available on commercially reasonable terms or at all. Some of this technology could be difficult to replace once integrated. The loss of, or inability to obtain, these licenses could result in delays or reductions of our applications until we identify, license and integrate or develop equivalent software, and new licenses could require us to pay higher royalties. If we are unable to successfully license and integrate third party technology, we could experience a reduction in functionality and/or errors or failures of our products, which may reduce demand for our products and services.

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Third-party licenses may expose us to increased risks, including risks associated with the integration of new technology, the impact of new technology integration on our existing technology, the diversion of resources from the development of our own proprietary technology, and our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs.

**We believe our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.**

Accounting principles generally accepted in the U.S. are subject to interpretation by the FASB, the American Institute of Certified Public Accountants, the SEC, and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

**Our reputation depends, in part, on factors which are partially or entirely outside of our control.**

Our services typically appear under the LivePerson brand or as a LivePerson-branded icon on our clients' websites. The customer service operators who respond to the inquiries of our clients' Internet users are employees or agents of our clients; they are not our employees. The experts who respond to the inquiries of Internet users are independent consultants or agents of our clients; they are not our employees. As a result, we are not able to control the actions of these operators or experts. In addition, an Internet user may not know that the operator or expert is not a LivePerson employee. If an Internet user were to have a negative experience in a LivePerson-powered real-time dialogue, it is possible that this experience could be attributed to us, which could diminish our brand and harm our business. Finally, we believe the success of our business services is aided by the prominent placement of the chat icon on a client's website, over which we also have no control.

**Political, economic and military conditions in Israel could negatively impact our Israeli operations**

Our product development staff, help desk and online sales support operations are located in Israel. As of December 31, 2010, we had 294 full-time employees in Israel. Although substantially all of our sales to date have been made to customers outside Israel, we are directly influenced by the political, economic and military conditions affecting Israel. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity, has caused security and economic problems in Israel. Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, primarily but not exclusively in the West Bank and Gaza Strip, and negotiations between the State of Israel and Palestinian representatives have effectively ceased. The election of representatives of the Hamas movement to a majority of seats in the Palestinian Legislative Council in January 2006 created additional unrest and uncertainty in the region. In July and August of 2006, Israel was involved in a full-scale armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group and political party, in southern Lebanon, which involved missile strikes against civilian targets in northern Israel that resulted in economic losses. Since June 2007, there has been an escalation in violence in the Gaza Strip. In December 2008 and January 2009, Israel engaged in an armed conflict with Hamas, which involved civilian targets in various parts of Israel and negatively affected business conditions in Israel. Recent popular uprisings in various countries in the Middle East and northern Africa are affecting the political stability of those countries. This instability may lead to deterioration of the political and trade relationships that exist between the State of Israel and these countries. In addition, this instability

may affect the global economy and marketplace through changes in oil and gas prices. Continued hostilities between Israel and its neighbors and any future armed conflict, terrorist activity or political instability in the region could adversely affect our operations in Israel and adversely affect the market price of our ordinary shares. Further escalation of tensions or violence might require more widespread military reserve service by some of our Israeli employees and might result in a significant downturn in the economic or financial condition of Israel, either of which could have a material adverse effect on our operations in Israel and our business. In addition, several Arab countries still restrict business with Israeli companies. Our operations in Israel could be adversely affected by restrictive laws or policies directed towards Israel and Israeli businesses.

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**Capital needs necessary to execute our business strategy could increase substantially and we may not be able to secure additional financing to execute this strategy.**

We believe that our current cash and cash equivalents and cash generated from operations, if any, will be sufficient to fund our working capital and capital expenditure requirements for at least the next twelve months. To the extent that we require additional funds to support our operations or the expansion of our business, or to pay for acquisitions, we may need to sell additional equity, issue debt or convertible securities or obtain credit facilities through financial institutions. In the past, we have obtained financing principally through the sale of preferred stock, common stock and warrants. If additional funds are raised through the issuance of debt or preferred equity securities, these securities could have rights, preferences and privileges senior to holders of common stock, and could have terms that impose restrictions on our operations. If additional funds are raised through the issuance of additional equity or convertible securities, our stockholders could suffer dilution. We cannot assure you that additional funding, if required, will be available to us in amounts or on terms acceptable to us. If sufficient funds are not available or are not available on acceptable terms, our ability to fund any potential expansion, take advantage of acquisition opportunities, develop or enhance our services or products, or otherwise respond to competitive pressures would be significantly limited. Those limitations would materially and adversely affect our business, results of operations and financial condition.

## **Risks Related to Our Industry**

**We are dependent on the continued growth and acceptance of the Internet as a medium for commerce, and the related expansion of the Internet infrastructure.**

We cannot be sure that a sufficiently broad base of consumers will continue to use the Internet as a medium for commerce. Convincing our clients to offer real-time sales, marketing and customer service technology may be difficult. The continuation of the Internet as a viable commercial marketplace is subject to a number of factors, including:

- continued growth in the number of users;
- concerns about transaction security or security problems such as viruses and worms or hackers;
- concerns about the security of confidential information online;
- continued development of the necessary technological infrastructure;
- development of enabling technologies;
- uncertain and increasing government regulation; and
- the development of complementary services and products.

**Future regulation of the Internet may slow our growth, resulting in decreased demand for our services and increased costs of doing business.**

State, federal and foreign regulators could adopt laws and regulations that impose additional burdens on companies that conduct business online. These laws and regulations could discourage communication by e-mail or other web-based communications, particularly targeted e-mail of the type facilitated by our services, which could reduce demand for our services.

The growth and development of the market for online services may prompt calls for more stringent consumer protection laws or laws that may inhibit the use of Internet-based communications or the information contained in these communications. The adoption of any additional laws or regulations may decrease the expansion of the Internet. A decline in the growth of the Internet, particularly as it relates to online communication, could decrease demand for our services and increase our costs of doing business, or otherwise harm our business. Any new legislation or regulations, application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or application of existing laws and regulations to the Internet and other online services could increase our costs and harm our growth.

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**We depend on the continued viability of the infrastructure of the Internet.**

To the extent that the Internet continues to experience growth in the number of users and frequency of use by consumers resulting in increased bandwidth demands, we cannot assure you that the infrastructure for the Internet will be able to support the demands placed upon it. The Internet has experienced outages and delays as a result of damage to portions of its infrastructure. Outages or delays could adversely affect online sites, email and the level of traffic on the Internet. We also depend on Internet service providers that provide our clients and Internet users with access to the LivePerson services. In the past, users have experienced difficulties due to system failures unrelated to our service. In addition, the Internet could lose its viability due to delays in the adoption of new standards and protocols required to handle increased levels of Internet activity. Insufficient availability of telecommunications services to support the Internet also could result in slower response times and negatively impact use of the Internet generally, and our clients sites (including the LivePerson dialogue windows) in particular. If the use of the Internet fails to grow or grows more slowly than expected, if the infrastructure for the Internet does not effectively support growth that may occur or if the Internet does not become a viable commercial marketplace, we may not maintain profitability and our business, results of operations and financial condition will suffer.

**Other Risks**

**Our stock price has been highly volatile and may experience extreme price and volume fluctuations in the future, which could reduce the value of your investment and subject us to litigation.**

Fluctuations in market price and volume are particularly common among securities of Internet and other technology companies. The market price of our common stock has fluctuated significantly in the past and may continue to be highly volatile, with extreme price and volume fluctuations, in response to the following factors, some of which are beyond our control:

- variations in our quarterly operating results;
- changes in market valuations of publicly-traded companies in general and Internet and other technology companies in particular;
- our announcements of significant client contracts, acquisitions and our ability to integrate these acquisitions, strategic partnerships, joint ventures or capital commitments;
- our failure to complete significant sales;
- additions or departures of key personnel;
- future sales of our common stock;
- changes in financial estimates by securities analysts; and

terrorist attacks against the United States, in Israel, or in the United Kingdom, the engagement in hostilities or an escalation of hostilities by or against the United States, Israel, or the United Kingdom, or the declaration of war or national emergency by the United States, Israel, or the United Kingdom.

In the past, companies that have experienced volatility in the market price of their stock have been the subject of securities class action litigation. We may in the future be the target of similar litigation, which could result in substantial costs and distract management from other important aspects of operating our business.

**Our common stock is traded on more than one market and this may result in price variations.**

Shares of our common stock are currently traded on the NASDAQ Capital Market and the Tel Aviv Stock Exchange ( TASE ). Trading in our common stock on these markets takes place in different currencies (U.S. dollars on NASDAQ and NIS on the TASE), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). The trading prices of our common stock on these two markets may differ due to these and other factors. Any decrease in the trading

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price of our common stock on one of these markets could cause a decrease in the trading price of our common stock on the other market. Differences in trading prices on the two markets could negatively impact our trading price.

**Our stockholders who each own greater than five percent of the outstanding common stock and our named executive officers and directors will be able to influence matters requiring a stockholder vote.**

Our stockholders who each own greater than five percent of the outstanding common stock and their affiliates, and our named executive officers and directors, in the aggregate, and as of December 31, 2010, beneficially own approximately 44.9% of our outstanding common stock. As a result, these stockholders, if acting together, will be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions. This concentration of ownership could also have the effect of delaying or preventing a change in control.

**The future sale of shares of our common stock may negatively affect our stock price.**

If our stockholders sell substantial amounts of our common stock, including shares issuable upon the exercise of outstanding options and warrants in the public market, or if our stockholders are perceived by the market as intending to sell substantial amounts of our common stock, the market price of our common stock could fall. These sales also might make it more difficult for us to sell equity securities in the future at a time and price that we deem appropriate. No prediction can be made as to the effect, if any, that market sales of our common stock will have on the market price of our common stock.

**Anti-takeover provisions in our charter documents and Delaware law may make it difficult for a third party to acquire us.**

Provisions of our amended and restated certificate of incorporation, such as our staggered Board of Directors, the manner in which director vacancies may be filled and provisions regarding the calling of stockholder meetings, could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders. In addition, provisions of our amended and restated bylaws, such as advance notice requirements for stockholder proposals, and applicable provisions of Delaware law, such as the application of business combination limitations, could impose similar difficulties. Further, provisions of our amended and restated certificate of incorporation relating to directors, stockholder meetings, limitation of director liability, indemnification and amendment of the certificate of incorporation and bylaws may not be amended without the affirmative vote of not less than 66.67% of the outstanding shares of our capital stock entitled to vote generally in the election of directors (considered for this purpose as a single class) cast at a meeting of our stockholders called for that purpose. Our amended and restated bylaws may not be amended without the affirmative vote of at least 66.67% of our Board of Directors or without the affirmative vote of not less than 66.67% of the outstanding shares of our capital stock entitled to vote generally in the election of directors (considered for this purpose as a single class) cast at a meeting of our stockholders called for that purpose.

**Item 1B. Unresolved Staff Comments**

None.



## Item 2. Properties

We currently lease approximately 17,000 square feet at our headquarters location in New York City, under a lease expiring in July 2011. In March 2010, we signed a lease for new office space approximately 18,500 square feet expiring in April 2020.

Two of our wholly-owned subsidiaries, LivePerson Ltd. (formerly HumanClick Ltd.) and Kasamba, Ltd., maintain offices in Raanana, Israel of approximately 44,000 square feet, under leases expiring in December 2010. In February 2010, they signed a lease for new office space of approximately 46,000 square feet expiring in December 2015.

Our wholly-owned subsidiary, Proficient Systems, Inc. maintains offices in Atlanta, Georgia of approximately 9,000 square feet, under a lease expiring in November 2015.

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Our wholly-owned subsidiary, LivePerson (UK) Ltd. maintains offices in Reading, United Kingdom of approximately 1,000 square feet, under a lease expiring in May 2011.

We also lease space for our primary and back-up hosting facilities at separate locations in the continental U.S and Europe.

We believe that our properties are in good condition, are well maintained and are suitable and adequate to carry on our operations for the foreseeable future.

### **Item 3. Legal Proceedings**

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

On January 20, 2011, our patent litigation against InstantService, Inc., together with all related claims and counterclaims, was dismissed pursuant to a settlement agreement entered by the parties. The terms of the settlement are confidential. The settlement of this litigation did not have a material effect on our results of operations, financial condition or cash flows.

On November 3, 2010, Gemini IP LLC filed an amended complaint in a suit pending in the United States District Court for the Eastern District of Texas, adding patent infringement allegations against us and various other defendants, including LANDesk Software, Inc., Saba Software, Inc., Genesys S.A. d/b/a Genesys Conferencing, Genesys Conferencing, Inc., Avaya Inc., Best Buy Co., Inc., Bomgar Corporation, ConnectWise, Inc., Elsinore Technologies Inc., GFI Software Ltd., GFI USA, Inc., GFI Software Development, Ltd., LogMeIn, Inc., N-able Technologies Incorporated, NTR Global, Venti Solutions, LLC, Zoho Corporation, Zenith Infotech Ltd., International Business Machines Corp., Samsung Electronics America, Inc., Samsung Electronics Co., Ltd., Samsung Telecommunications America, LLC, AT&T, Inc., Sony Corporation, and Sony Corporation of America. Gemini seeks damages for past infringement, and an injunction against future infringement of the patent in suit. We believe Gemini's claims are without merit. On January 10, 2011, we answered the complaint, asserting numerous affirmative defenses including non-infringement and invalidity of the patent in suit, and we also counterclaimed for a declaratory judgment of non-infringement and invalidity of the patent in suit. No schedule for proceedings in this matter has been set by the Court at this time. We intend to vigorously defend against Gemini's allegations, and vigorously pursue our counterclaims. We have not accrued for this contingency as of December 31, 2010, because the amount of loss, if any, cannot be reasonably estimated at this time.

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

## **Item 4. Reserved**

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TABLE OF CONTENTS**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Price Range of Common Stock**

The principal United States market on which our common stock is traded is The Nasdaq Capital Market of The Nasdaq Stock Market under the symbol LPSN. The following table sets forth, for each full quarterly period within the two most recent fiscal years, the high and low sales prices (in U.S. dollars per share) of our common stock as reported or quoted on The Nasdaq Capital Market:

|                               | High     | Low     |
|-------------------------------|----------|---------|
| Year ended December 31, 2010: |          |         |
| First Quarter                 | \$ 8.13  | \$ 5.85 |
| Second Quarter                | \$ 8.94  | \$ 5.99 |
| Third Quarter                 | \$ 8.77  | \$ 6.10 |
| Fourth Quarter                | \$ 11.75 | \$ 8.47 |
| Year ended December 31, 2009: |          |         |
| First Quarter                 | \$ 2.27  | \$ 1.68 |
| Second Quarter                | \$ 4.19  | \$ 2.28 |
| Third Quarter                 | \$ 5.15  | \$ 3.81 |
| Fourth Quarter                | \$ 7.20  | \$ 4.76 |

 **Holders**

As of March 1, 2011, there were approximately 210 holders of record of our common stock.

 **Dividends**

We have not declared or paid any cash dividends on our capital stock since our inception. We intend to retain earnings, if any, to finance the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future.

 **Issuer Purchases of Equity Securities**

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

The following table summarizes repurchases of our common stock under our stock repurchase program during the quarter ended December 31, 2010:

| Period | Total Number of Shares | Average Price Paid per Share | Total Number of Shares | Approximate Dollar Value of |
|--------|------------------------|------------------------------|------------------------|-----------------------------|
|--------|------------------------|------------------------------|------------------------|-----------------------------|

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|                      | Purchased | Purchased as Part of Publicly Announced Plans or Programs | Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------|-----------|---|--|
| 10/1/2010 10/31/2010 | \$        |   | \$ 6,365,000 <sup>(1)</sup>                                  |
| 11/1/2010 11/30/2010 |           |   | 6,365,000  |
| 12/1/2010 12/31/2010 |           |   | 6,365,000  |
| Total                | \$        |   | \$ 6,365,000   |

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 (1) depending upon prevailing market conditions and other corporate considerations, up to an aggregate purchase price of \$10.0 million. As of March 1, 2011, \$6.4 million remained available for purchases under the program.

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## Stock Performance Graph

The graph depicted below compares the annual percentage changes in the LivePerson's cumulative total stockholder return with the cumulative total return of the Standard & Poor's SmallCap 600 Index and the Standard & Poor's Information Technology Index.

Notes:

(1) The graph covers the period from December 31, 2005 to December 31, 2010.

(2) The graph assumes that \$100 was invested at the market close on December 31, 2005 in LivePerson's Common Stock, in the Standard & Poor's SmallCap 600 Index and in the Standard & Poor's Information Technology Index, and that all dividends were reinvested. No cash dividends have been declared on LivePerson's Common Stock.

(3) Stockholder returns over the indicated period should not be considered indicative of future stockholder returns. *Notwithstanding anything to the contrary set forth in any of our previous or future filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate by reference this Annual Report on Form 10-K or future filings made by the Company under those statutes, the Stock Performance Graph above is not deemed filed with the Securities and Exchange Commission, is not deemed soliciting material and shall not be deemed incorporated by reference into any of those prior filings or into any future filings made by us under those statutes, except to the extent that we specifically incorporate such information by reference into a previous or future filing, or specifically requests that such information be treated as soliciting material, in each case under those statutes.*

TABLE OF CONTENTS**Item 6. Selected Consolidated Financial Data**

The selected consolidated financial data with respect to our consolidated balance sheets as of December 31, 2010 and 2009 and the related consolidated statements of operations for the years ended December 31, 2010, 2009 and 2008 have been derived from our audited consolidated financial statements which are included herein. The selected financial data with respect to our balance sheets as of December 31, 2008, 2007 and 2006 and the related statements of operations for the years ended December 31, 2007 and 2006 have been derived from our audited financial statements which are not included herein. Due to our acquisitions of NuConomy in April 2010, Kasamba in October 2007 and Proficient in July 2006, we believe that comparisons of our operating results with each other, or with those of prior periods, may not be meaningful. The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto and the information contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

|  | Year Ended December 31,                         |            |             |            |            |
|--|---|------------|-------------|------------|------------|
|  | 2010  | 2009       | 2008        | 2007       | 2006       |
|  | (In Thousands, Except Share and per Share Data) |            |             |            |            |
| Consolidated Statement of Operations Data:   |   |            |             |            |            |
| Revenue  | \$ 109,862                                      | \$ 87,490  | \$ 74,655   | \$ 52,228  | \$ 33,521  |
| Operating expenses:  |   |            |             |            |            |
| Cost of revenue  | 29,640  | 21,076     | 20,307      | 13,534     | 7,621      |
| Product development  | 15,711  | 12,111     | 12,899      | 9,032      | 5,062      |
| Sales and marketing  | 32,835  | 27,355     | 26,124      | 16,124     | 11,864     |
| General and administrative   | 17,077  | 13,417     | 13,042      | 9,208      | 6,542      |
| Amortization of intangibles  | 259   | 745        | 1,407       | 1,116      | 1,383      |
| Goodwill impairment  |   |            | 23,501      |            |            |
| Total operating expenses   | 95,522  | 74,704     | 97,280      | 49,014     | 32,472     |
| Income (loss) from operations  | 14,340  | 12,786     | (22,625)    | 3,214      | 1,049      |
| Other (expense) income :   |   |            |             |            |            |
| Financial (expense)  | (106)   | (80)       | (376)       | (18)       | (58)       |
| Interest income  | 99  | 94         | 329         | 914        | 773        |
| Total other (expense) income, net  | (7)   | 14         | (47)        | 896        | 715        |
| Income (loss) before (provision for) benefit from income taxes                                   | 14,333  | 12,800     | (22,672)    | 4,110      | 1,764      |
| (Provision for) benefit from income taxes <sup>(1)</sup>   | (5,074)   | (5,037)    | (1,165)     | 1,711      | 438        |
| Net income (loss) attributable to common stockholders  | \$ 9,259  | \$ 7,763   | \$ (23,837) | \$ 5,821   | \$ 2,202   |
| Basic net income (loss) per common share   | \$ 0.18   | \$ 0.16    | \$ (0.50)   | \$ 0.13    | \$ 0.06    |
| Diluted net income (loss) per common share   | \$ 0.18   | \$ 0.16    | \$ (0.50)   | \$ 0.12    | \$ 0.05    |
| Weighted average shares outstanding used in basic net income (loss) per common share calculation | 50,721,880                                      | 47,962,688 | 47,428,251  | 43,696,378 | 39,680,182 |

|  |            |            |            |            |            |
|--|------------|------------|------------|------------|------------|
| Weighted average shares outstanding<br>used in diluted net income (loss) per<br>common share calculation | 52,907,541 | 49,008,440 | 47,428,251 | 46,814,080 | 43,345,232 |
|--|------------|------------|------------|------------|------------|

(1) For the years ended December 31, 2007 and 2006, the benefit from income taxes is related the release of the Company's valuation allowance against deferred tax assets.

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|                           | December 31,   |           |           |           |           |
|---------------------------|----------------|-----------|-----------|-----------|-----------|
|                           | 2010           | 2009      | 2008      | 2007      | 2006      |
|                           | (In Thousands) |           |           |           |           |
| Consolidated              |                |           |           |           |           |
| Balance Sheet Data:       |                |           |           |           |           |
| Cash and cash equivalents | \$ 61,336      | \$ 45,572 | \$ 25,500 | \$ 26,222 | \$ 21,729 |
| Working capital           | 61,600         | 39,996    | 19,924    | 17,641    | 19,233    |
| Total assets              | 131,143        | 104,281   | 81,948    | 102,488   | 43,315    |
| Total stockholders equity | 104,643        | 81,137    | 63,583    | 84,712    | 34,549    |

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## Item 7. 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 consolidated financial statements, which are prepared in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that management believes are reasonable based upon the information available. We base these estimates on our historical experience, future expectations and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments that may not be readily apparent from other sources. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions relate to estimates of the carrying amount of goodwill, intangibles, stock based-compensation, valuation allowances for deferred income taxes, accounts receivable, the expected term of a client relationship, accruals and other factors. We evaluate these estimates on an ongoing basis. Actual results could differ from those estimates under different assumptions or conditions, and any differences could be material.

### Overview

LivePerson provides online engagement solutions that facilitate real-time assistance and expert advice. Connecting businesses and independent experts with individual consumers seeking help on the Web, 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.

We are organized into two operating segments. The Business segment facilitates real-time online interactions – chat, voice/click-to-call, email and self-service/knowledgebase for global corporations of all sizes. The Consumer segment facilitates online transactions between independent experts and individual consumers.

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

*Expanding Business with Existing Customers and Adding New Customers.* We are expanding our sales capacity by adding enterprise sales agents, and by establishing a midmarket sales group that will focus on adding new customers that are larger than our typical SMB customers, but smaller than our largest enterprise customers. We have also expanded our efforts to retain existing SMB customers through increased interaction with them during the early stages of their usage of our services.

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

*Expanding Research and Development Investment to Support New Product Initiatives.* We are increasing our investment in new product development efforts to expand future product offerings. We are also investing in partner programs that enable third-parties to develop value-added software applications for our existing and future customers.



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## **Financial Overview for the Three and Twelve Months Ended December 31, 2010**

Financial overview of the three and twelve months ended December 31, 2010 compared to the comparable periods in 2009 are as follows:

Revenue increased 21% and 26% to \$29.9 million and \$109.9 million in the three and twelve months ended December 31, 2010, respectively from \$24.8 million and \$87.5 million in the comparable periods in 2009.

Gross profit margin decreased to 72% and 73% in the three and twelve months ended December 31, 2010 from 76% in the in the comparable periods in 2009.

Operating expenses increased 28% to \$25.8 million and \$95.5 million in the three and twelve months ended December 31, 2010, respectively from \$20.1 million and \$74.7 million in the comparable periods in 2009.

Net income decreased 11% to \$2.7 million in the three months ended December 31, 2010 from net income of \$3.1 million for the three months ended December 31, 2009. Net income increased 19% to \$9.3 million in the twelve months ended December 31, 2010 from net income of \$7.8 million for the twelve months ended December 31, 2009.

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

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

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

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

We recognize monthly service revenue based upon the fee charged for the LivePerson services, provided that there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable. Our service agreements typically have twelve month terms and are terminable or may terminate upon 30 to 90 days notice without penalty. When professional service fees provide added value to the customer on a standalone basis, we recognize professional service fees upon completion and customer acceptance because we have established objective and reliable evidence of the fair value of the undelivered hosting services. If a

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professional services arrangement does not qualify for separate accounting, we recognize the fees, and the related labor costs, ratably over a period of 48 months, representing our current estimate of the term of the client relationship.

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

### **Stock-Based Compensation**

We follow ASC 718-10, Stock Compensation, which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. ASC 718-10 is a revision to SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. 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 December 31, 2010, there was approximately \$14.7 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 2.4 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. Our concentration of credit risk is limited due to our large number of customers. No single customer accounted for or exceeded 10% of our total revenue in 2010, 2009 and 2008. One customer accounted for approximately 22% and 12% of accounts receivable at December 31, 2010 and 2009, respectively. We increased our allowance for doubtful accounts by \$166,000 to approximately \$561,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles.

### **Goodwill**

In accordance with ASC 350-10, Goodwill and Other Intangible Assets, goodwill and indefinite-lived intangible assets are not amortized, but reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value below its carrying amount. Goodwill is required to be tested for impairment at least annually. Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of

significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. To assist in the process of determining goodwill impairment, we will obtain appraisals from an independent valuation firm. In addition to the use of an independent valuation firm, we will perform internal valuation analyses and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions including projected future cash flows (including timing), discount rates

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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 2010, the Company evaluated goodwill using a combination of discounted cash flows, prior transactions and quoted market prices methods and determined that no impairment had occurred.

### **Impairment of Long-Lived Assets**

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

### **Use of Estimates**

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

### **Recently Issued FASB Accounting Standards Updates**

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

In January 2010, the FASB published FASB Accounting Standards Update 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements. This update requires some new



disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require: (a) a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and (b) in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures: for purposes of

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reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. As ASU 2010-06 relates specifically to disclosures, it will not have an impact on our consolidated financial statements.

In October 2009, FASB Accounting Standards Update 2009-13 addressed the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Specifically, this update amends the criteria in Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements, for separating consideration in multiple-deliverable arrangements. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. FASB Accounting Standards Update 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We are currently assessing the impact of this update on our consolidated financial statements.

## **Revenue**

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

Revenue from our Business segment accounted for 87% of total revenue for the year ended December 31, 2010. Revenue from our Business segment accounted for 86% of total revenue for the years ended December 31, 2009 and 2008. Revenue attributable to our monthly hosted Business services accounted for 95% of total Business revenue for the year ended December 31, 2010. Revenue attributable to our monthly hosted Business services accounted for 96% of total Business revenue for the year ended December 31, 2009. Revenue attributable to our monthly hosted Business services accounted for 94% of total Business revenue for the year ended December 31, 2008. Our service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days' notice without penalty. Given the time required to schedule training for our clients' operators and our clients' resource constraints, we have historically experienced a lag between signing a client contract and recognizing revenue from that client. This lag has recently ranged from 30 to 90 days.

Revenue from our Consumer segment is generated from online transactions between Experts and Users and is recognized net of expert fees and accounted for approximately 13% of total revenue for the year ended December 31, 2010. Revenue generated from online transactions between Experts and Users accounted for approximately 14% of total revenue for the years ended December 31, 2009 and 2008.

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.

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**Operating Expenses**

Our cost of revenue consists of:

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

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

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

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

During 2010, we increased our allowance for doubtful accounts by \$166,000 to approximately \$561,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. During 2009, we increased our allowance for doubtful accounts by \$68,000 to approximately \$408,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. We wrote off approximately \$13,000 of previously reserved accounts, leaving a net allowance for doubtful accounts of \$395,000. 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 years ended December 31, 2010, 2009 and 2008 consist of:

|  | 2010           | 2009     | 2008     |
|--|----------------|----------|----------|
|  | (In Thousands) |          |          |
| Stock-based compensation expense related to ASC 718-10 | \$ 5,142       | \$ 4,726 | \$ 4,266 |
| Total  | \$ 5,142       | \$ 4,726 | \$ 4,266 |

## Results of Operations

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

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**Comparison of Fiscal Years Ended December 31, 2010 and 2009**

*Revenue Business.* Revenue increased by 27% to \$95.7 million for the year ended December 31, 2010, from \$75.6 million for the year ended December 31, 2009. This increase is primarily attributable to revenue from new clients in the amount of approximately \$12.0 million and, to a lesser extent, to revenue from existing clients who increased their use of our services in the amount of approximately \$6.9 million, net of cancellations, partially offset by a decrease in professional services revenue of approximately \$1.2 million. Our revenue growth has traditionally been driven by a mix of revenue from new clients as well as expansion from existing clients.

*Revenue Consumer.* Revenue increased by 19% to \$14.2 million for the year ended December 31, 2010, from \$11.9 million for the year ended December 31, 2009. This increase is primarily attributable to an increase in gross revenue of approximately \$1.8 million as a result of higher rates charged by experts. In addition, net revenue also increased due to an increase in the fees we charge experts of approximately \$500,000.

*Cost of Revenue Business.* Cost of revenue consists of compensation costs relating to employees who provide customer service to our clients, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure, and allocated occupancy costs and related overhead. Cost of revenue increased by 48% to \$25.9 million in 2010, from \$17.5 million in 2009. This increase in expense is primarily attributable to an increase for primary and backup server facilities and allocated overhead related to costs of supporting our server and network infrastructure of approximately \$4.1 million as a result of increased revenue and an increase in total compensation and related costs for additional and existing customer service and network operations personnel in the amount of approximately \$4.1 million. The increase in cost of revenue in excess of revenue growth was driven primarily by increased investment in more robust business continuity capabilities within our hosting facilities. In addition, costs related to data collection and storage has increased, as we have improved the scope and quality of the analytical reporting we provide to our larger customers.

*Cost of Revenue Consumer.* Cost of revenue consists of compensation costs relating to employees who provide customer service to Experts and Users, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure, credit card and transaction processing fees and related costs, and allocated occupancy costs and related overhead. Cost of revenue increased by 6% to \$3.8 million in 2010, from \$3.6 million in 2009. This increase is primarily attributable to an increase in credit card and transaction processing fees and related costs in the amount of approximately \$97,000 and to an increase in primary and backup server facilities and allocated overhead related to costs of supporting our server and network infrastructure of approximately \$80,000 as a result of increased revenue and an increase in total compensation and related costs for additional and existing customer service and network support personnel in the amount of approximately \$50,000.

*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 30% to \$15.7 million in 2010, from \$12.1 million in 2009. This increase is primarily attributable to an increase in compensation and related costs for additional and existing product development personnel as a result of our increased efforts to expand our product offerings of approximately \$3.1 million and allocated occupancy costs and related overhead in the amount of approximately \$477,000. We are increasing our investment in new product development efforts to expand future product offerings. We are also investing in partner programs that enable third-parties to develop value-added software applications for our existing and future customers.

*Sales and Marketing Business.* Our sales and marketing expenses consist of compensation and related expenses for sales and marketing personnel, as well as advertising, public relations, trade show exhibit expenses and allocated

occupancy costs and related overhead. Sales and marketing expenses increased by 29% to \$26.2 million in 2010, from \$20.4 million in 2009. This increase is primarily attributable to an increase in compensation and related costs for additional and existing sales and marketing personnel of approximately \$4.9 million, an increase in allocated occupancy costs and related overhead in the amount of approximately

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\$478,000 and an increase in advertising, public relations and trade show exhibit expenses of approximately \$457,000. This increase relates to our continued efforts to enhance our brand recognition and increase sales lead activity.

*Sales and Marketing Consumer.* Our sales and marketing expenses consist of compensation and related expenses for marketing personnel, as well as online promotion, public relations, trade show exhibit expenses and allocated occupancy costs and related overhead. Sales and marketing expenses decreased by 5% to \$6.7 million in 2010, from \$7.0 million in 2009. This decrease is primarily attributable to a decrease in advertising and promotional expenses of approximately \$423,000 driven by improved efficiency in search engine optimization partially offset by an increase in compensation and related costs and allocated overhead for additional and existing marketing personnel in the amount of approximately \$69,000.

*General and Administrative.* Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, legal, human resources and administrative personnel. General and administrative expenses increased by 27% to \$17.1 million in 2010, from \$13.4 million in 2009. This increase is primarily attributable to an increase in compensation and related expenses for additional and existing accounting, legal and human resource personnel in the amount of approximately \$1.4 million and increases in rent, legal and other professional, corporate learning and development and telephone in the amounts of \$849,000, \$844,000, \$306,000 and \$257,000, respectively.

*Amortization of Intangibles.* Amortization expense was \$259,000 and \$745,000 in the years ended December 31, 2010 and 2009, respectively, and relates primarily to acquisition costs recorded as a result of our acquisition of Kasamba in October 2007 and Proficient in July 2006. This decrease is attributable to the fact that the intangible assets related to the Proficient acquisition were fully amortized in 2009. Additional amortization expense in the amount of \$1.2 million is included in cost of revenue for the years ended December 31, 2010 and 2009. Amortization expense is expected to be approximately \$964,000 in the year ended December 31, 2011.

*Other (Expense) Income.* Financial expense was \$106,000 and \$80,000 in the twelve months ended December 31, 2010 and 2009 respectively, and relates to unfavorable currency rate movements, related to our Israeli operations. Interest income was \$99,000 and \$94,000 in the twelve months ended December 31, 2010 and 2009 respectively, and consists of interest earned on cash and cash equivalents. These increases are primarily attributable to our increases in cash and cash equivalents partially offset to decreases in short term interest rates.

*(Provision for) Income Taxes.* For the year ended December 31, 2010, our effective tax rate was 35.4% resulting in a provision for income taxes of \$5.1 million. For the year ended December 31, 2009, our effective tax rate was 39.4% resulting in a provision for income taxes of \$5.0 million in 2009. The decrease in effective tax rate is primarily due to an increase in deductible expenses resulting from disqualifying dispositions from the exercise of incentive stock options in the year ended December 31, 2010.

*Net Income.* We had net income of \$9.3 million in 2010 compared to net income of \$7.8 million in 2009. Revenue increased \$22.4 million while operating expenses increased by \$20.8 million, contributing to a net increase in income from operations of \$1.6 million.

## **Comparison of Fiscal Years Ended December 31, 2009 and 2008**

*Revenue Business.* Revenue increased by 18% to \$75.6 million for the year ended December 31, 2009, from \$64.1 million for the year ended December 31, 2008. This increase is primarily attributable to revenue from new clients in the amount of approximately \$7.0 million and, to a lesser extent, to revenue from existing clients who increased their



use of our services in the amount of approximately \$4.5 million, net of cancellations, partially offset by a decrease in professional services revenue of approximately \$317,000. Our revenue growth has traditionally been driven by a mix of revenue from new clients as well as expansion from existing clients.

*Revenue Consumer.* Revenue increased by 13% to \$11.9 million for the year ended December 31, 2009, from \$10.6 million for the year ended December 31, 2008. This increase is primarily attributable to a 15% increase in the fees we charge experts in the amount of approximately \$1.2 million and, to a lesser extent, to an increase in gross revenue in the amount of approximately \$150,000.

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*Cost of Revenue Business.* Cost of revenue consists of compensation costs relating to employees who provide customer service to our clients, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure, and allocated occupancy costs and related overhead. Cost of revenue increased by 6% to \$17.5 million in 2009, from \$16.6 million in 2008. This increase in expense is primarily attributable to an increase in primary and backup server facilities and allocated overhead related to costs of supporting our server and network infrastructure of approximately \$1.2 million as a result of increased revenue and was partially offset by lower total compensation costs for our customer service and network support personnel and costs of supporting our server and network infrastructure in the amount of approximately \$263,000.

*Cost of Revenue Consumer.* Cost of revenue consists of compensation costs relating to employees who provide customer service to Experts and Users, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure, credit card and transaction processing fees and related costs, and allocated occupancy costs and related overhead. Cost of revenue decreased by 4% to \$3.6 million in 2009, from \$3.7 million in 2008. This decrease is primarily attributable to lower total compensation costs for our customer service and network support personnel and costs of supporting our server and network infrastructure in the amount of approximately \$224,000 and was partially offset by an increase in expenses for primary and backup server facilities and allocated overhead related to costs of supporting our server and network infrastructure of approximately \$107,000 as a result of increased revenue.

*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 decreased by 6% to \$12.1 million in 2009, from \$12.9 million in 2008. This decrease is primarily attributable to lower total compensation costs for product development personnel as a result of favorable currency rate movements related to our Israeli operations as compared to the same period in 2008.

*Sales and Marketing Business.* Our sales and marketing expenses consist of compensation and related expenses for sales and marketing personnel, as well as advertising, public relations and trade show exhibit expenses. Sales and marketing expenses increased by 14% to \$20.4 million in 2009, from \$17.8 million in 2008. This increase is primarily attributable to an increase in costs related to additional sales and marketing personnel of approximately \$2.6 million. This increase relates to our continued efforts to enhance our brand recognition and increase sales lead activity.

*Sales and Marketing Consumer.* Our sales and marketing expenses consist of compensation and related expenses for marketing personnel, as well as online promotion, public relations and trade show exhibit expenses. Sales and marketing expenses decreased by 15% to \$7.0 million in 2009, from \$8.3 million in 2008. This decrease is primarily attributable to more efficient allocation of advertising and promotional spending that resulted in a decrease in expenses of approximately \$1.8 million and was partially offset by an increase in compensation and allocated overhead for marketing personnel in the amount of approximately \$604,000.

*General and Administrative.* Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, legal, human resources and administrative personnel. General and administrative expenses increased by 3% to \$13.4 million in 2009, from \$13.0 million in 2008. The increase is primarily attributable to increases in compensation expense of approximately \$947,000 partially offset by a decrease in accounting, legal, recruiting and related overhead in the amount of \$557,000.

*Amortization of Intangibles.* Amortization expense was \$745,000 and \$1.4 million in the years ended December 31, 2009 and 2008, respectively, and relates primarily to acquisition costs recorded as a result of our acquisition of Kasamba in October 2007 and Proficient in July 2006. Amortization expense is expected to be approximately \$1.5 million in the year ended December 31, 2010.

*Other Income (Expense)*. Financial expense in 2009 was \$80,000 and \$376,000 in the twelve months ended December 31, 2009 and 2008 respectively, and relates to unfavorable currency rate movements, related to our Israeli operations. Interest income was \$94,000 and \$329,000 in the twelve months ended December 31, 2009 and 2008 respectively, and consists of interest earned on cash and cash equivalents. These decreases are primarily attributable to decreases in short-term interest rates.

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*(Provision for) Benefit from Income Taxes.* For the year ended December 31, 2009, our effective tax rate was 39.4% resulting in a provision for income taxes of \$5.0 million. For the year ended December 31, 2008, our effective tax rate was 5.1% resulting in a provision for income taxes of \$1.2 million in 2008. Although we had a net loss of \$23.8 million in 2008, we generated taxable income because the net loss was driven primarily by a non-deductible goodwill impairment charge.

*Net Income (Loss).* We had net income of \$7.8 million in 2009 compared to net loss of \$23.8 million in 2008. Revenue increased \$12.8 million and operating expenses decreased \$22.6 million, contributing to a net increase in income from operations of \$35.4 million. The decrease in operating expenses is primarily attributable to a goodwill impairment charge in the amount of \$23.5 million in 2008. Excluding the impact of the goodwill impairment in 2008, income from operations increased as compared to 2008 due primarily to net income in both Business and Consumer segments.

## **Liquidity and Capital Resources**

As of December 31, 2010, we had approximately \$61.3 million in cash and cash equivalents, an increase of approximately \$15.8 million from December 31, 2009. This increase is primarily attributable to net cash provided by operating activities and, to a lesser extent, proceeds from the issuance of common stock in connection with the exercise of stock options by employees and the excess tax benefit from the exercise of employee stock options, partially offset by the purchases of fixed assets related to the build-out of our collocation facility. We invest our cash in short-term money market funds.

Net cash provided by operating activities was \$15.5 million in the year ended December 31, 2010 and consisted of net income, non-cash expenses related to ASC-718-10, amortization of intangibles and depreciation, and increases in deferred revenue, accounts payable and accrued expenses, deferred income taxes, partially offset by an increase in accounts receivable, prepaid expenses and other current assets. Net cash provided by operating activities was \$21.0 million in the year ended December 31, 2009 and consisted of net income, increases in accounts payable, accrued expenses, deferred income taxes, non-cash expenses related to ASC 718-10, depreciation and to the amortization of intangibles partially offset by decreases in accounts receivable and prepaid expenses and other current assets.

Net cash used in investing activities was \$8.9 million in the year ended December 31, 2010 and was due primarily to purchase of fixed assets for our collocation facilities. Net cash used in investing activities was \$6.0 million in the year ended December 31, 2009 and was due primarily to purchase of fixed assets.

Net cash provided by financing activities was \$9.2 million in the year ended December 31, 2010 and consisted primarily of the proceeds from the issuance of common stock in connection with the exercise of stock options by employees and the excess tax benefit from exercise of employee stock options and partially offset by the repurchase of common stock. Net cash provided by financing activities was \$5.1 million in the year ended December 31, 2009 and consisted primarily of the excess tax benefit from exercise of employee stock options and the proceeds from the issuance of common stock in connection with the exercise of stock options by employees partially offset by the repurchase of common stock.

We have incurred significant expenses to develop our technology and services, to hire employees in our customer service, sales, marketing and administration departments, and for the amortization of intangible assets, as well as non-cash compensation costs. Historically, we incurred significant quarterly net losses from inception through June 30, 2003, significant negative cash flows from operations in our quarterly periods from inception through December 31, 2002. As of December 31, 2010, we had an accumulated deficit of approximately \$100.1 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

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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 years ended December 31, 2010 and 2009 was approximately \$6.4 million and \$4.9 million, respectively.

As of December 31, 2010, our principal commitments were approximately \$23.4 million under various operating leases, of which approximately \$7.2 million is due in 2011. We do not currently expect that our principal commitments for the year ending December 31, 2011 will exceed \$8.0 million in the aggregate. Our capital expenditures are not currently expected to exceed \$8.0 million in 2011.

Our contractual obligations at December 31, 2010 are summarized as follows:

| Contractual Obligations | Payments Due by Period<br>(In Thousands) |                     |           |           |                      |
|-------------------------|--|---------------------|-----------|-----------|----------------------|
|                         | Total                                    | Less Than 1<br>Year | 1 3 Years | 3 5 Years | More Than 5<br>Years |
| Operating leases        | \$ 23,409                                | \$ 7,219            | \$ 11,541 | \$ 2,647  | \$ 2,002             |
| Total                   | \$ 23,409                                | \$ 7,219            | \$ 11,541 | \$ 2,647  | \$ 2,002             |

### Capital Expenditures

During 2007, we began to build a collocation facility in the eastern U.S. to host the Business and Consumer services.

During 2010, the Company began to build additional collocation facilities in Europe to host the LivePerson and Consumer services. Through December 31, 2010, we spent approximately \$17.9 million for servers, network components and related hardware and software. Though we expect to incur additional costs in 2011 related to the continued build-out of our collocation facilities and similar backup facilities to support disaster recovery capabilities in the U.S and U.K, our total capital expenditures are not currently expected to exceed \$8.0 million in 2011. We anticipate that our current cash and cash equivalents from operations will be sufficient to complete the build-out.

## Item 7A. 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. For the year ended December 31, 2010, the U.S dollar depreciated approximately 5% as compared to the NIS which had a negative

impact on our results of operations and financial conditions when compared to the same period in 2009. For the year ended December 31, 2010, expenses incurred by our Israeli operations totaled \$31.7 million. We do not currently hedge our foreign currency risk exposure. We actively monitor the movement of the U.S. dollar against the NIS and U.K. pound and have considered the use of financial instruments, including but not limited to derivative financial instruments, which could mitigate such risk. If we determine that our risk of exposure materially exceeds the potential cost of derivative financial instruments, we may in the future enter in to these types of investments. The functional currency of our wholly-owned Israeli subsidiaries, LivePerson Ltd. (formerly HumanClick Ltd.) and Kasamba Ltd., is the U.S. dollar and the functional currency of our operations in the United Kingdom is the U.K. pound.

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## **Collection Risk**

Our accounts receivable are subject, in the normal course of business, to collection risks. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of collection risks. During 2010, we increased our allowance for doubtful accounts \$166,000 to approximately \$561,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. During 2009, we increased our allowance for doubtful accounts by \$68,000 to approximately \$408,000, principally due to an increase in accounts receivable as a result of increased sales. A larger proportion of receivables are due from larger corporate clients that typically have longer payment cycles. We wrote off approximately \$13,000 of previously reserved accounts, leaving a net allowance for doubtful accounts of \$395,000.

## **Interest Rate Risk**

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



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**Item 8. Consolidated Financial Statements and Supplementary Data**

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# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
LivePerson, Inc.  
New York, NY

We have audited the accompanying consolidated balance sheets of LivePerson, Inc. as of December 31, 2010 and 2009 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LivePerson, Inc. at December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), LivePerson, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 15, 2011 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

New York, New York  
March 15, 2011

TABLE OF CONTENTS**LIVEPERSON, INC.****CONSOLIDATED BALANCE SHEETS  
(In Thousands, Except Share and per Share Data)**

|   | December 31, |           |
|---|--------------|-----------|
|   | 2010         | 2009      |
| <b>ASSETS</b>   |              |           |
| Current assets:   |              |           |
| Cash and cash equivalents   | \$61,336     | \$45,572  |
| Accounts receivable, net of allowance for doubtful accounts of \$561 and \$395, in 2010 and 2009, respectively  | 16,491       | 10,265    |
| Prepaid expenses and other current assets   | 6,341        | 3,661     |
| Deferred tax assets, net  | 1,529        | 1,460     |
| Total current assets  | 85,697       | 60,958    |
| Property and equipment, net   | 12,762       | 9,551     |
| Intangibles, net  | 2,124        | 2,821     |
| Goodwill  | 24,015       | 23,920    |
| Deferred tax assets, net  | 3,876        | 4,777     |
| Deferred implementation costs, net of current   | 164          | 136       |
| Security deposits   | 499          | 326       |
| Other assets  | 2,006        | 1,792     |
| Total assets  | \$131,143    | \$104,281 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |              |           |
| Current liabilities:  |              |           |
| Accounts payable  | \$6,416      | \$5,375   |
| Accrued expenses  | 12,111       | 10,895    |
| Deferred revenue  | 5,570        | 4,692     |
| Total current liabilities   | 24,097       | 20,962    |
| Deferred revenue, net of current  | 513          | 506       |
| Other liabilities   | 1,890        | 1,676     |
| Total liabilities   | 26,500       | 23,144    |
| Commitments and contingencies   |              |           |
| Stockholders equity:  |              |           |
| Preferred stock, \$.001 par value per share; 5,000,000 shares authorized, 0 issued and outstanding at December 31, 2010 and 2009  |              |           |
| Common stock, \$.001 par value per share; 100,000,000 shares authorized, 51,753,842 shares issued and outstanding at December 31, 2010; 49,435,682 shares issued and outstanding at December 31, 2009 | 52           | 49        |
| Additional paid-in capital  | 205,063      | 190,692   |
| Accumulated deficit   | (100,173)    | (109,432) |
| Accumulated other comprehensive loss  | (299 )       | (172 )    |
| Total stockholders equity   | 104,643      | 81,137    |

|  |           |           |
|--|-----------|-----------|
| Total liabilities and stockholders' equity | \$131,143 | \$104,281 |
|--|-----------|-----------|

*See accompanying notes to consolidated financial statements.*

TABLE OF CONTENTS**LIVEPERSON, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS  
(In Thousands, Except Share and per Share Data)**

|  | Year Ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2010                    | 2009       | 2008       |
| Revenue  | \$ 109,862              | \$ 87,490  | \$ 74,655  |
| Operating expenses:  |                         |            |            |
| Cost of revenue  | 29,640                  | 21,076     | 20,307     |
| Product development  | 15,711                  | 12,111     | 12,899     |
| Sales and marketing  | 32,835                  | 27,355     | 26,124     |
| General and administrative   | 17,077                  | 13,417     | 13,042     |
| Amortization of intangibles  | 259                     | 745        | 1,407      |
| Goodwill impairment  |                         |            | 23,501     |
| Total operating expenses   | 95,522                  | 74,704     | 97,280     |
| Income (loss) from operations  | 14,340                  | 12,786     | (22,625 )  |
| Other (expense) income:  |                         |            |            |
| Financial expense  | (106 )                  | (80 )      | (376 )     |
| Interest income  | 99                      | 94         | 329        |
| Total other (expense) income, net  | (7 )                    | 14         | (47 )      |
| Income (loss) before provision for income taxes  | 14,333                  | 12,800     | (22,672 )  |
| Provision for income taxes   | (5,074 )                | (5,037 )   | (1,165 )   |
| Net income (loss)  | 9,259                   | 7,763      | (23,837 )  |
| Basic net income (loss) per common share   | \$0.18                  | \$0.16     | \$(0.50 )  |
| Diluted net income (loss) per common share   | \$0.18                  | \$0.16     | \$(0.50 )  |
| Weighted average shares outstanding used in basic net income (loss) per common share calculation   | 50,721,880              | 47,962,688 | 47,428,251 |
| Weighted average shares outstanding used in diluted net income (loss) per common share calculation | 52,907,541              | 49,008,440 | 47,428,251 |

*See accompanying notes to consolidated financial statements.*

TABLE OF CONTENTS**LIVEPERSON, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS  
EQUITY  
(In Thousands, Except Share Data)**

|   | Common Stock<br>Shares | Common Stock<br>Amount | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Accumulated<br>Other<br>Comprehensive<br>Total |
|---|------------------------|------------------------|----------------------------------|------------------------|---|--|
| Balance at December 31, 2007                              | 47,892,128             | \$ 48                  | \$ 178,041                       | \$(93,358 )            | \$( 19 )                                      | \$ 84,712                                      |
| Repurchase of common stock                                | (1,374,217 )           | ( 2 )                  | (4,067 )                         |                        |   | (4,069 )                                       |
| Common stock issued upon<br>exercise of stock options     | 839,106                | 1                      | 912                              |                        |   | 913  |
| Stock-based compensation                                  |                        |                        | 4,266                            |                        |   | 4,266  |
| Tax benefit from exercise of<br>employee stock options    |                        |                        | 1,717                            |                        |   | 1,717  |
| Net loss  |                        |                        |                                  | (23,837 )              |   | (23,837 )                                      |
| Other comprehensive loss                                  |                        |                        |                                  |                        | (119 )  | (119 )   |
| Comprehensive loss  |                        |                        |                                  |                        |   | (23,956 )                                      |
| Balance at December 31, 2008                              | 47,357,017             | 47                     | 180,869                          | (117,195 )             | (138 )  | 63,583   |
| Repurchase of common stock                                | (16,223 )              |                        | (28 )                            |                        |   | (28 )  |
| Common stock issued upon<br>exercise of stock options     | 2,094,888              | 2                      | 4,189                            |                        |   | 4,191  |
| Stock-based compensation                                  |                        |                        | 4,726                            |                        |   | 4,726  |
| Tax benefit from exercise of<br>employee stock options    |                        |                        | 936                              |                        |   | 936  |
| Net income  |                        |                        |                                  | 7,763                  |   | 7,763  |
| Other comprehensive loss                                  |                        |                        |                                  |                        | (34 )   | (34 )  |
| Comprehensive income                                      |                        |                        |                                  |                        |   | 7,729  |
| Balance at December 31, 2009                              | 49,435,682             | 49                     | 190,692                          | (109,432 )             | (172 )  | 81,137   |
| Repurchase of common stock                                | (534,496 )             |                        | (3,649 )                         |                        |   | (3,649 )                                       |
| Common stock issued upon<br>exercise of stock options     | 2,843,547              | 3                      | 11,407                           |                        |   | 11,410   |
| Stock-based compensation                                  |                        |                        | 5,142                            |                        |   | 5,142  |
| Common stock issued under<br>Employee Stock Purchase Plan | 9,109                  |                        | 74                               |                        |   | 74   |
| Tax benefit from exercise of<br>employee stock options    |                        |                        | 1,397                            |                        |   | 1,397  |
| Net income  |                        |                        |                                  | 9,259                  |   | 9,259  |
| Other comprehensive loss                                  |                        |                        |                                  |                        | (127 )  | (127 )   |
| Comprehensive income                                      |                        |                        |                                  |                        |   | 9,132  |
| Balance at December 31, 2010                              | 51,753,842             | \$ 52                  | \$ 205,063                       | \$(100,173 )           | \$( 299 )                                     | \$ 104,643                                     |

*See accompanying notes to consolidated financial statements.*

TABLE OF CONTENTS**LIVEPERSON, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands)**

|  | Year Ended December 31, |          |            |
|--|-------------------------|----------|------------|
|  | 2010                    | 2009     | 2008       |
| Cash flows from operating activities:  |                         |          |            |
| Net income (loss)  | \$9,259                 | \$7,763  | \$(23,837) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:       |                         |          |            |
| Goodwill impairment  |                         |          | 23,501     |
| Stock-based compensation expense   | 5,142                   | 4,726    | 4,266      |
| Depreciation   | 5,791                   | 3,347    | 2,093      |
| Amortization of intangibles  | 1,486                   | 1,973    | 2,634      |
| Provision for doubtful accounts, net   | 166                     | 68       | 148        |
| Deferred income taxes  | 832                     | 2,865    | (1,091 )   |
| Changes in operating assets and liabilities, net of acquisition:                               |                         |          |            |
| Accounts receivable  | (6,391 )                | (2,760 ) | (1,696 )   |
| Prepaid expenses and other current assets  | (2,687 )                | (1,948 ) | (78 )      |
| Deferred implementation costs  | (28 )                   | 12       | (67 )      |
| Security deposits  | (174 )                  | 23       | 150        |
| Other assets   |                         | (116 )   |            |
| Accounts payable   | 45                      | 1,836    | 1,293      |
| Accrued expenses   | 1,224                   | 2,367    | 337        |
| Deferred revenue   | 884                     | 866      | 332        |
| Net cash provided by operating activities  | 15,549                  | 21,022   | 7,985      |
| Cash flows from investing activities:  |                         |          |            |
| Purchases of property and equipment, including capitalized software                            | (8,002 )                | (5,442 ) | (6,833 )   |
| Acquisition of Kasamba, net of cash acquired   |                         |          | (111 )     |
| Acquisition of NuConomy, net of cash acquired  | (789 )                  |          |            |
| Acquisition of Proficient  | (95 )                   | (98 )    | (205 )     |
| Acquisition of patents   |                         | (475 )   |            |
| Net cash used in investing activities  | (8,886 )                | (6,015 ) | (7,149 )   |
| Cash flows from financing activities:  |                         |          |            |
| Repurchase of common stock   | (3,649 )                | (28 )    | (4,069 )   |
| Excess tax benefit from the exercise of employee stock options and warrants                    | 1,397                   | 936      | 1,717      |
| Proceeds from issuance of common stock in connection with the exercise of options and warrants | 11,484                  | 4,191    | 913        |
| Net cash provided by (used in) financing activities  | 9,232                   | 5,099    | (1,439 )   |
| Effect of foreign exchange rate changes on cash and cash equivalents                           | (131 )                  | (34 )    | (119 )     |
| Net increase (decrease) in cash and cash equivalents   | 15,764                  | 20,072   | (722 )     |



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|  |          |          |          |
|--|----------|----------|----------|
| Cash and cash equivalents at the beginning of the year | 45,572   | 25,500   | 26,222   |
| Cash and cash equivalents at the end of the year       | \$61,336 | \$45,572 | \$25,500 |

*See accompanying notes to consolidated financial statements.*

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**LIVEPERSON, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands, Except Share Data)**

**Supplemental disclosure of non-cash investing and financing activities:**

Cash flows from investing activities for the years ended December 31, 2010, 2009 and 2008 do not include the purchases of approximately \$1,259, \$259 and \$276, respectively of capitalized equipment related to the Company's collocation facility as the corresponding invoices are included in accounts payable for the corresponding year end period, and therefore did not have an impact on cash flows for the corresponding year end period.

During the years ended December 31, 2010, 2009 and 2008 total net cash paid for income taxes were \$3,800, \$2,000 and \$180, respectively.

During the year ended December 31, 2009, the Company settled a pre-acquisition contingency resulting in a decrease in accrued expenses in the amount of \$566.

*See accompanying notes to consolidated financial statements.*

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**LIVEPERSON, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**(1) Summary of Operations and Significant Accounting Policies**

**(a) Summary of Operations**

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

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

**(b) Principles of Consolidation**

The consolidated financial statements reflect the operations of LivePerson and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

**(c) Use of Estimates**

The preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the U.S. requires the Company's 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, and accruals. Actual results could differ from those estimates.

**(d) Cash and Cash Equivalents**

The Company considers all highly liquid securities with original maturities of three months or less when acquired to be cash equivalents. Cash equivalents, which primarily consist of money market funds, are recorded at cost, which approximates fair value.

### **(e) Property and Equipment**

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets, generally three to five years for equipment and software. Leasehold improvements are depreciated using the straight-line method over the shorter of the lease term or the estimated useful life of the asset. Total depreciation for the years ended December 31, 2010, 2009 and 2008 was \$5,791, \$3,347, and \$2,093, respectively.

### **(f) Impairment of Long-Lived Assets**

In accordance with the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 360-10, Accounting for the Impairment or Disposal of Long-lived Assets, long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying value of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying value of the asset exceeds the fair value of the asset. Assets to be disposed of

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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.

**(g) Accounts Receivable**

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectability. All other balances are reviewed on a pooled basis. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers.

**(h) Revenue Recognition**

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

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

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

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

The Company recognizes monthly service revenue based upon the fee charged for the LivePerson services, provided that there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable. The Company's service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days notice without penalty. When professional service fees provide added value to the customer on a standalone basis, the Company recognizes professional service fees upon completion and customer acceptance because they have established objective and reliable evidence of the

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fair value of the undelivered hosting services. If a professional services arrangement does not qualify for separate accounting, the Company recognizes the fees, and the related labor costs, ratably over a period of 48 months, representing the Company's current estimate of the term of the client relationship.

For revenue generated from online transactions between Experts and Users, the Company recognizes revenue net of the expert fees in accordance with ASC 605-45, Principal Agent Considerations, due to the fact that the Company performs as an agent without any risk of loss for collection. The Company collects a fee from the 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.

**(i) Income Taxes**

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that the tax change occurs. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

**(j) Advertising Costs**

The Company expenses the cost of advertising and promoting its services as incurred. Such costs totaled approximately \$6,132, \$6,098, and \$7,784 for the years ended December 31, 2010, 2009 and 2008, respectively.

**(k) Financial Instruments and Concentration of Credit Risk**

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable which approximate fair value at December 31, 2010 because of the short-term nature of these instruments. The Company invests its cash and cash equivalents with financial institutions that it believes are of high quality, and performs periodic evaluations of these instruments and the relative credit standings of the institutions with which it invests. At certain times, the Company's cash balances with any one financial institution may exceed Federal Deposit Insurance Corporation insurance limits. The Company

believes it mitigates its risk by depositing its cash balances with high credit, quality financial institutions.

The Company's customers are located primarily in the United States. The Company performs ongoing credit evaluations of its customers' financial condition (except for customers who purchase the LivePerson services by credit card via Internet download) and has established an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information. Concentration of credit risk is limited due to the Company's large number of customers. No single customer accounted for or exceeded 10% of revenue in 2010, 2009 or 2008. One customer accounted for approximately 22% and 12% of accounts receivable at December 31, 2010 and 2009, respectively.

### **(I) 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



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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.

ASC 718-10 requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Consolidated Statements of Operations. Stock-based compensation recognized in the Company's Consolidated Statement of Operations for the years ended December 31, 2010, 2009 and 2008 includes compensation expense for share-based awards granted prior to, but not fully vested as of January 1, 2006 based on the grant date fair value estimated in accordance with ASC 718-10 as well as compensation expense for share-based awards granted subsequent to January 1, 2006 in accordance with ASC 718-10. The Company currently uses the Black-Scholes option pricing model to determine grant date fair value.

The following table summarizes stock-based compensation expense related to employee stock options under ASC 718-10 included in Company's Statement of Operations for the years ended December 31, 2010, 2009 and 2008:

|   | December 31, |          |          |
|---|--------------|----------|----------|
|   | 2010         | 2009     | 2008     |
| Cost of revenue   | \$866        | \$ 790   | \$ 557   |
| Product development expense                                   | 1,329        | 1,402    | 1,287    |
| Sales and marketing expense                                   | 1,371        | 1,337    | 1,250    |
| General and administrative expense                            | 1,576        | 1,197    | 1,172    |
| Total stock based compensation included in operating expenses | \$5,142      | \$ 4,726 | \$ 4,266 |

The per share weighted average fair value of stock options granted during the years ended December 31, 2010, 2009 and 2008 was \$3.89, \$1.53 and \$1.84, 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 for the years ended December 31, 2010, 2009 and 2008:

|                         | December 31, |      |      |      |      |      |
|-------------------------|--------------|------|------|------|------|------|
|                         | 2010         | 2009 | 2008 |      |      |      |
| Dividend yield          | 0.0%         | 0.0% | 0.0% |      |      |      |
| Risk-free interest rate | 2.6%         | 3.8% | 2.8% | 3.9% | 1.9% | 4.0% |

|                          |       |       |       |       |       |       |
|--------------------------|-------|-------|-------|-------|-------|-------|
| Expected life (in years) | 5.0   | 5.0   | 4.2   | 5.0   |       |       |
| Historical volatility    | 60.3% | 61.9% | 61.3% | 68.2% | 68.5% | 71.5% |

**(m) Basic and Diluted Net Income per Share**

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

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Diluted net income per common share for the year ended December 31, 2010 includes the effect of options to purchase 5,294,867 shares of common stock with a weighted average exercise price of \$3.61. Diluted net income per common share for the year ended December 31, 2010 does not include the effect of options to purchase 3,524,395 shares of common stock as the effect of their inclusion is anti-dilutive. Diluted net income per common share for the year ended December 31, 2009 includes the effect of options to purchase 3,358,569 shares of common stock with a weighted average exercise price of \$2.04. Diluted net income per common share for the year ended December 31, 2009 does not include the effect of options to purchase 5,353,242 shares of common stock as the effect of their inclusion is anti-dilutive.

Diluted net income per common share for the year ended December 31, 2008 does not include the effects of options to purchase 9,939,045 shares of common stock and warrants to purchase 63,000 shares of common stock as the effect of their inclusion is anti-dilutive. A reconciliation of shares used in calculating basic and diluted earnings per share follows:

|                                     | Year Ended December 31, |            |            |
|-------------------------------------|-------------------------|------------|------------|
|                                     | 2010                    | 2009       | 2008       |
| Basic                               | 50,721,880              | 47,962,688 | 47,428,251 |
| Effect of assumed exercised options | 2,185,661               | 1,045,752  |            |
| Diluted                             | 52,907,541              | 49,008,440 | 47,428,251 |

**(n) Segment Reporting**

The Company accounts for its segment information in accordance with the provisions of ASC 280-10, Segment Reporting. ASC 280-10 establishes annual and interim reporting standards for operating segments of a company. ASC 280-10 requires disclosures of selected segment-related financial information about products, major customers, and geographic areas based on the Company's internal accounting methods. Due to the acquisition of Kasamba Inc. in October 2007, the Company is organized into two operating segments for purposes of making operating decisions and assessing performance. The Business segment supports and manages real-time online interactions chat, voice/click-to-call, email and self-service/knowledgebase and sells its products and services to global corporations of all sizes. The Consumer segment facilitates online transactions between Experts and Users and sells its services to consumers. Both segments currently generate their revenue primarily in the U.S. The chief operating decision-makers evaluate performance, make operating decisions, and allocate resources based on the operating income of each segment. The reporting segments follow the same accounting policies used in the preparation of the Company's consolidated financial statements which are described in the summary of significant accounting policies. The Company allocates cost of revenue, sales and marketing and amortization of purchased intangibles to the segments,

but it does not allocate product development expenses, general and administrative expenses and income tax expense because management does not use this information to measure performance of the operating segments. There are currently no intersegment sales.

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Summarized financial information by segment for the year ended December 31, 2010, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | Consolidated | Corporate    | Business  | Consumer |
|--------------------------------|--------------|--------------|-----------|----------|
| Revenue:                       |              |              |           |          |
| Hosted services Business       | \$ 91,262    | \$           | \$ 91,262 | \$       |
| Hosted services Consumer       | 14,195       |              |           | 14,195   |
| Professional services          | 4,405        |              | 4,405     |          |
| Total revenue                  | 109,862      |              | 95,667    | 14,195   |
| Cost of revenue                | 29,640       |              | 25,863    | 3,777    |
| Sales and marketing            | 32,835       |              | 26,184    | 6,651    |
| Amortization of intangibles    | 259          |              | 43        | 216      |
| Unallocated corporate expenses | 32,788       | 32,788       |           |          |
| Operating income (loss)        | \$ 14,340    | \$ (32,788 ) | \$ 43,577 | \$ 3,551 |

Summarized financial information by segment for the year ended December 31, 2009, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

|                                | Consolidated | Corporate    | Business  | Consumer |
|--------------------------------|--------------|--------------|-----------|----------|
| Revenue:                       |              |              |           |          |
| Hosted services Business       | \$ 72,372    | \$           | \$ 72,372 | \$       |
| Hosted services Consumer       | 11,942       |              |           | 11,942   |
| Professional services          | 3,176        |              | 3,176     |          |
| Total revenue                  | 87,490       |              | 75,548    | 11,942   |
| Cost of revenue                | 21,076       |              | 17,522    | 3,554    |
| Sales and marketing            | 27,355       |              | 20,350    | 7,005    |
| Amortization of intangibles    | 745          |              | 457       | 288      |
| Unallocated corporate expenses | 25,528       | 25,528       |           |          |
| Operating income (loss)        | \$ 12,786    | \$ (25,528 ) | \$ 37,219 | \$ 1,095 |

Summarized financial information by segment for the year ended December 31, 2008, based on the Company's internal financial reporting system utilized by the Company's chief operating decision makers, follows:

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|                                | Consolidated | Corporate    | Business  | Consumer     |
|--------------------------------|--------------|--------------|-----------|--------------|
| Revenue:                       |              |              |           |              |
| Hosted services Business       | \$ 60,601    | \$           | \$ 60,601 | \$           |
| Hosted services Consumer       | 10,560       |              |           | 10,560       |
| Professional services          | 3,494        |              | 3,494     |              |
| Total revenue                  | 74,655       |              | 64,095    | 10,560       |
| Cost of revenue                | 20,307       |              | 16,597    | 3,710        |
| Sales and marketing            | 26,124       |              | 17,837    | 8,287        |
| Amortization of intangibles    | 1,407        |              | 886       | 521          |
| Goodwill impairment            | 23,501       |              |           | 23,501       |
| Unallocated corporate expenses | 25,941       | 25,941       |           |              |
| Operating (loss) income        | \$ (22,625 ) | \$ (25,941 ) | \$ 28,775 | \$ (25,459 ) |

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Revenues attributable to domestic and foreign operations follows:

|                 | December 31, |           |           |
|-----------------|--------------|-----------|-----------|
|                 | 2010         | 2009      | 2008      |
| United States   | \$ 84,725    | \$ 67,244 | \$ 55,749 |
| United Kingdom  | 14,110       | 9,650     | 8,026     |
| Other Countries | 11,027       | 10,596    | 10,880    |
| Total revenue   | \$ 109,862   | \$ 87,490 | \$ 74,655 |

Long-lived assets by geographic region follows:

|                         | December 31, |           |
|-------------------------|--------------|-----------|
|                         | 2010         | 2009      |
| United States           | \$ 31,710    | \$ 29,508 |
| Israel                  | 13,736       | 13,815    |
| Total long-lived assets | \$ 45,446    | \$ 43,323 |

**(o) Comprehensive Loss**

ASC 220-10, Reporting Comprehensive Income, requires the Company to report in its consolidated financial statements, in addition to its net income, comprehensive loss, which includes all changes in equity during a period from non-owner sources including, as applicable, foreign currency items, minimum pension liability adjustments and unrealized gains and losses on certain investments in debt and equity securities. The Company's comprehensive loss for all periods presented is related to the effect of foreign translation losses.

**(p) Computer Software**

The Company follows the provisions of ASC 350-40, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. ASC 350-40 provides guidance for determining whether computer software is internal-use software and on accounting for the proceeds of computer software originally developed or obtained for internal use and then subsequently sold to the public. It also provides guidance on capitalization of the costs incurred for computer software developed or obtained for internal use. The Company capitalized \$536 as of December 31, 2010 and \$847 as of December 31, 2009. Software costs are included in Property and equipment, net on the Company's balance sheet and are depreciated using the straight-line method over their estimated useful life, generally three years.

## **(q) Goodwill and Intangible Assets**

The Company follows the provisions of ASC 350-10, Goodwill and Other Intangible Assets, ( ASC 350-10 ). Pursuant to ASC 350-10, goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually using a measurement date of July 31. In 2010 and 2009, the Company evaluated goodwill using a combination of discounted cash flows, prior transactions and quoted market price methods and determined that no impairment had occurred. Goodwill has been allocated to the Company's operating segments, for the purposes of preparing our impairment analyses, based on a specific identification basis. ASC 350-10 also requires that intangible assets with estimatable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with ASC 360-10-35, Accounting for Impairment or Disposal of Long-Lived Assets. In 2008, the Company recorded a non-cash goodwill impairment charge in the amount of \$23,501.



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**(r) Deferred Rent**

The Company records rent expense on a straight-line basis over the term of the related lease. The difference between the rent expense recognized for financial reporting purposes and the actual payments made in accordance with the lease agreement is recognized as deferred rent liability on the Company's balance sheet.

**(s) Foreign Currency Translation**

Assets and liabilities in foreign functional currencies are translated at the exchange rate as of the balance sheet date. Translation adjustments are recorded as a separate component of stockholders' equity. Revenue, costs and expenses denominated in foreign functional currencies are translated at the weighted average exchange rate for the period. The translation adjustment of \$127, \$34 and \$119 for the years ended December 31, 2010, 2009 and 2008, respectively, is related to the Company's wholly-owned United Kingdom subsidiary. The functional currency of the Company's wholly-owned Israeli subsidiaries is the U.S. dollar.

**(t) Recently Issued Accounting Standard Updates**

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

In January 2010, the FASB published FASB Accounting Standards Update 2010-06, Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures about Fair Value Measurements. This update requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the

transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require: (a) a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and (b) in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures: for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. As ASU 2010-06 relates specifically to disclosures, it will not have an impact on the Company's consolidated financial statements.

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(In Thousands, Except Share and per Share Data)****(1) Summary of Operations and Significant Accounting Policies  
(continued)**

In October 2009, FASB Accounting Standards Update 2009-13 addressed the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Specifically, this update amends the criteria in Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements, for separating consideration in multiple-deliverable arrangements. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. FASB Accounting Standards Update 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company is currently assessing the impact of this update on its consolidated financial statements.

**(u) Fair Value of Financial Instruments**

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. Cash and cash equivalents, accounts receivable, security deposits, accounts payable and deferred revenue carrying amounts approximate fair value because of the short maturity of these instruments.

**(v) Goodwill and Intangible Assets**

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

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

The changes in the carrying amount of goodwill for the year ended December 31, 2009 are as follows:

|                                 | Total     | Business  | Consumer |
|---------------------------------|-----------|-----------|----------|
| Balance as of December 31, 2008 | \$ 24,388 | \$ 15,798 | \$ 8,590 |

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|   |           |           |          |
|---|-----------|-----------|----------|
| Adjustments to goodwill:                  |           |           |          |
| Contingent earnout payments               | 98        | 98        |          |
| Settlement of pre-acquisition contingency | (566 )    |           | (566 )   |
| Balance as of December 31, 2009           | \$ 23,920 | \$ 15,896 | \$ 8,024 |

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(In Thousands, Except Share and per Share Data)****(1) Summary of Operations and Significant Accounting Policies  
(continued)**

Intangible assets are summarized as follows (see Note 2):

**Acquired Intangible Assets**

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

|                               | As of December 31, 2009     |   |                             |
|-------------------------------|-----------------------------|---|-----------------------------|
|                               | Gross<br>Carrying<br>Amount | Weighted<br>Average<br>Amortization<br>Period | Accumulated<br>Amortization |
| Amortizing intangible assets: |                             |   |                             |
| Technology                    | \$ 5,410                    | 3.8 years                                     | \$ 3,262                    |
| Customer contracts            | 2,400                       | 3.0 years                                     | 2,400                       |
| Trade names                   | 630                         | 3.0 years                                     | 473                         |
| Non-compete agreements        | 410                         | 1.2 years                                     | 410                         |
| Patents                       | 475                         | 11.0 years                                    | 18                          |
| Other                         | 235                         | 3.0 years                                     | 176                         |
| Total                         | \$ 9,560                    |   | \$ 6,739                    |

Amortization expense is calculated on a straight-line basis over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was \$1,486, \$1,973 and \$2,634 for the years ended December 31, 2010, 2009 and 2008, respectively. For the years ended December 31, 2010 and 2009, a portion of this amortization is included in cost of revenue. Estimated amortization expense for the next five years is: \$964 in 2011, \$43 in 2012, \$43 in 2013, \$43 in 2014, \$43 in 2015 and \$199 thereafter.

## **(2) Acquisitions**

### **Proficient Systems**

On July 18, 2006, the Company acquired Proficient Systems, Inc. ( Proficient ), a provider of hosted proactive chat solutions that help companies generate revenue on their web sites. This transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of Proficient were included in the Company's consolidated results of operations from the date of acquisition. The acquisition added several U.K. based financial services clients and provided an innovative product marketing team. During the twelve months ended December 31, 2010, 2009, 2008 the Company incurred additional costs related to the earn-out litigation in the amount of \$95, \$98, \$79, respectively, resulting in an increase in goodwill. During the twelve months ended December 31, 2009, the Company incurred additional costs related to the earn-out litigation in the amount of \$98, resulting in an increase in goodwill. See Legal Proceedings and Note 9 of our consolidated financial statements for additional information regarding the Proficient litigation.

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**LIVEPERSON, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(In Thousands, Except Share and per Share Data)**

**(2) Acquisitions (continued)**

Based on the achievement of certain revenue targets as of March 31, 2007, LivePerson was contingently required to issue up to an additional 2,050,000 shares of common stock. Based on these targets, the Company issued 1,127,985 shares of common stock valued at \$8,894, based on the quoted market price of the Company's common stock on the date the contingency was resolved, and made a cash payment of \$20 related to this contingency. At March 31, 2007, the value of these shares has been allocated to goodwill with a corresponding increase in equity. In accordance with the purchase agreement, the earn-out consideration was subject to review by Proficient's Shareholders' Representative. On July 31, 2007, the Company was served with a complaint filed in the United States District Court for the Southern District of New York by the Shareholders' Representative of Proficient (Plaintiff). The complaint filed by the Shareholders' Representative sought certain documentation relating to calculation of the earn-out consideration, and demanded payment of damages on the grounds that substantially all of the remaining contingently issuable earn-out shares should have been paid. The Company believes the claims are without merit. The case recently proceeded to trial, which ended on November 4, 2010. Post-trial filings were due on November 19, 2010. In the event that the Court finds in whole or in part for Plaintiff, the Company would be required to pay monetary damages in the amount held by the Court to have been underpaid in the earn-out. The Company is presently unable to reasonably estimate the amount of actual damages, if any, that will be awarded by the Court. If the Court were to find in favor of Plaintiff on every claim at issue in the litigation, the maximum potential damages award would be approximately \$6,000. Should the Company be required to pay any damages award, the associated expense would be allocated to goodwill in connection with Proficient acquisition.

**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. During the twelve months ended December 31, 2009, the Company settled a pre-acquisition contingency resulting in a \$566 decrease in goodwill.

**NuConomy Ltd.**

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

### (3) Balance Sheet Components

#### Property and Equipment

Property and equipment is summarized as follows:

|  | December 31, |           |
|--|--------------|-----------|
|  | 2010         | 2009      |
| Computer equipment and software                | \$ 25,002    | \$ 17,045 |
| Furniture, equipment and building improvements | 1,856        | 811       |
|  | 26,858       | 17,856    |
| Less accumulated depreciation                  | 14,096       | 8,305     |
| Total  | \$ 12,762    | \$ 9,551  |

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(In Thousands, Except Share and per Share Data)****(3) Balance Sheet Components (continued)****Accrued Expenses**

Accrued expenses consist of the following:

|   | December 31, |           |
|---|--------------|-----------|
|   | 2010         | 2009      |
| Payroll and other employee related costs                | \$ 6,973     | \$ 7,557  |
| Professional services, consulting and other vendor fees | 4,211        | 2,370     |
| Sales commissions                                       | 565          | 608       |
| Other   | 362          | 360       |
| Total   | \$ 12,111    | \$ 10,895 |

**(4) Capitalization**

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

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 them depending upon prevailing market conditions and other corporate considerations, up to an aggregate purchase price of \$10.0 million. As of December 31, 2010, the Company had repurchased 534,496 shares of its common stock for an aggregate cost of approximately \$3.6 million.

**(5) Stock Options and Employee Stock Purchase Plan**

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

The Company established the 2009 Stock Incentive Plan (the 2009 Plan ) as a successor to the 2000 Plan. Under the 2009 Plan, the options which had been outstanding under the 2000 Plan were incorporated into the 2009 Plan and the Company increased the number of shares available for issuance under the plan by 6,000,000, thereby reserving for issuance 19,567,744 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have ten-year terms. As of December 31, 2010, approximately 15,066,000 shares of common stock were reserved for

issuance under the 2009 Plan (taking into account all option exercises through December 31, 2010). As of December 31, 2010, there was approximately \$14,659 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 2.4 years.

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

In June 2010, our stockholders approved the 2010 Employee Stock Purchase Plan with 1,000,000 shares of common stock initially reserved for issuance. As of December 31, 2010, approximately 991,000 shares of common stock were reserved for issuance under the Employee Stock Purchase Plan (taking into account all share purchases through December 31, 2010).

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(In Thousands, Except Share and per Share Data)****(5) Stock Options and Employee Stock Purchase Plan  
(continued)**

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

|  | Options      | Weighted<br>Average<br>Exercise<br>Price |
|--|--------------|--|
| Options outstanding at December 31, 2007 | 9,305,276    | \$ 3.72                                  |
| Options granted                          | 2,487,900    | 3.10                                     |
| Options exercised                        | (839,106 )   | 1.01                                     |
| Options cancelled                        | (1,015,025 ) | 4.59                                     |
| Options outstanding at December 31, 2008 | 9,939,045    | 3.67                                     |
| Options granted                          | 1,960,500    | 2.66                                     |
| Options exercised                        | (2,094,888 ) | 2.06                                     |
| Options cancelled                        | (1,092,849 ) | 3.65                                     |
| Options outstanding at December 31, 2009 | 8,711,808    | 3.82                                     |
| Options granted                          | 3,809,380    | 7.13                                     |
| Options exercised                        | (2,843,547 ) | 4.10                                     |
| Options cancelled                        | (860,881 )   | 5.09                                     |
| Options outstanding at December 31, 2010 | 8,816,760    | \$ 5.04                                  |
| Options exercisable at December 31, 2008 | 5,467,794    | \$ 3.14                                  |
| Options exercisable at December 31, 2009 | 4,463,915    | \$ 4.03                                  |
| Options exercisable at December 31, 2010 | 3,097,748    | \$ 3.93                                  |

The total intrinsic value of stock options exercised during the years ended December 31, 2010, 2009 and 2008 was approximately \$11,050, \$6,204 and \$1,782, respectively. The total intrinsic value of options exercisable at December 31, 2010, 2009 and 2008 was approximately \$22,491, \$12,799 and \$1,300, respectively. The total intrinsic value of options expected to vest at December 31, 2010, 2009 and 2008 is approximately \$32,420, \$14,318 and \$3, respectively. A summary of the status of the Company's nonvested shares as of December 31, 2008, and changes during the years ended December 31, 2009 and 2010 is as follows:

| Shares | Weighted<br>Average<br>Grant-Date<br>Fair Value |
|--------|---|
|--------|---|

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|                                       |             |         |
|---------------------------------------|-------------|---------|
| Nonvested Shares at January 1, 2009   | 4,471,251   | \$ 2.59 |
| Granted                               | 1,960,500   | 1.53    |
| Vested                                | (1,539,923) | 2.65    |
| Cancelled                             | (643,935 )  | 2.18    |
| Nonvested Shares at December 31, 2009 | 4,247,893   | \$ 2.13 |

|                                       |             |         |
|---------------------------------------|-------------|---------|
| Nonvested Shares at January 1, 2010   | 4,247,893   | \$ 2.13 |
| Granted                               | 3,809,380   | 3.89    |
| Vested                                | (1,521,951) | 2.41    |
| Cancelled                             | (816,310 )  | 2.83    |
| Nonvested Shares at December 31, 2010 | 5,719,012   | \$ 3.13 |

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(In Thousands, Except Share and per Share Data)****(6) Valuation and Qualifying Accounts**

|   | Balance at<br>Beginning<br>of<br>Period | Additions<br>Charged to<br>Costs and<br>Expenses | Deductions /<br>Write-Offs | Balance at<br>End of<br>Period |
|---|---|--|----------------------------|--------------------------------|
| For the year ended December 31, 2010<br>Allowance for doubtful accounts | \$ 395                                  | \$ 166   | \$                         | \$ 561                         |
| For the year ended December 31, 2009<br>Allowance for doubtful accounts | \$ 340                                  | \$ 68  | \$ (13 )                   | \$ 395                         |
| For the year ended December 31, 2008<br>Allowance for doubtful accounts | \$ 208                                  | \$ 148   | \$ (16 )                   | \$ 340                         |

**(7) Income Taxes**

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences are expected to become deductible.

Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. The Company includes interest accrued on the underpayment of income taxes in interest expense and penalties, if any, related to unrecognized tax benefits in general and administrative expenses.

Under Section 382 of the Internal Revenue Code of 1986, as amended, the Company's use of its federal net operating loss ( NOL ) carryforwards may be limited if the Company has experienced an ownership change, as defined in Section 382. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization.

As of December 31, 2010, the Company had approximately \$7,903 of federal NOL carryforwards available to offset future taxable income. Included in this amount is \$6,632 of federal NOL carryovers from the Company's acquisition of Proficient. These carryforwards expire in various years through 2027.

The domestic and foreign components of income (loss) before (provision for) income taxes consist of the following:

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|               | Year Ended December 31, |           |              |
|---------------|-------------------------|-----------|--------------|
|               | 2010                    | 2009      | 2008         |
| United States | \$ 12,478               | \$ 10,972 | \$ (23,877 ) |
| Foreign       | 1,855                   | 1,828     | 1,205        |
|               | \$ 14,333               | \$ 12,800 | \$ (22,672 ) |

No additional provision has been made for U.S. income taxes on the undistributed earnings of its Israeli subsidiary, LivePerson Ltd (formerly HumanClick Ltd.); as such earnings have been taxed in the U.S. and accumulated earnings of the Company's other foreign subsidiaries are immaterial through December 31, 2010.

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(In Thousands, Except Share and per Share Data)****(7) Income Taxes (continued)**

The provision for income taxes consists of the following:

|                             | Year Ended December 31, |          |          |
|-----------------------------|-------------------------|----------|----------|
|                             | 2010                    | 2009     | 2008     |
| Current income taxes:       |                         |          |          |
| U.S. Federal                | \$ 3,554                | \$ 1,418 | \$ 1,421 |
| State and local             | 473                     | 516      | 369      |
| Foreign                     | 215                     | 238      | 466      |
| Total current income taxes  | 4,242                   | 2,172    | 2,256    |
| Deferred income taxes:      |                         |          |          |
| U.S. Federal                | 694                     | 2,719    | (1,200 ) |
| State and local             | (60 )                   | 21       | 255      |
| Foreign                     | 198                     | 125      | (146 )   |
| Total deferred income taxes | 832                     | 2,865    | (1,091 ) |
| Total income taxes          | \$ 5,074                | \$ 5,037 | \$ 1,165 |

The difference between the total income taxes computed at the federal statutory rate and the benefit from income taxes consists of the following:

|                                     | Year Ended December 31, |          |           |
|-------------------------------------|-------------------------|----------|-----------|
|                                     | 2010                    | 2009     | 2008      |
| Federal Statutory Rate              | 34.30 %                 | 34.00 %  | (34.00 )% |
| State taxes, net of federal benefit | 2.27 %                  | 2.80 %   | 0.44 %    |
| Goodwill impairment                 | %                       | %        | 35.24 %   |
| Non-deductible expenses ISO         | (0.88 )%                | 2.19 %   | 2.38 %    |
| Non-deductible expenses Other       | 0.43 %                  | 0.26 %   | 0.22 %    |
| Change in state effective rate      | %                       | %        | 1.84 %    |
| Foreign taxes                       | (0.08 )%                | (0.44 )% | (0.34 )%  |
| Other                               | (0.64 )%                | 0.54 %   | (0.64 )%  |
| Total provision                     | 35.40 %                 | 39.35 %  | 5.14 %    |

The difference between the statutory federal income tax rate and the Company's effective tax rate in 2008 is principally due to a goodwill impairment charge.

The effects of temporary differences and tax loss carryforwards that give rise to significant portions of federal deferred tax assets and deferred tax liabilities at December 31, 2010 and 2009 are presented below:

|  | 2010     | 2009     |
|--|----------|----------|
| Deferred tax assets:                           |          |          |
| Net operating loss carryforwards               | \$ 2,720 | \$ 2,978 |
| Accounts payable and accrued expenses          | 317      | 375      |
| Non-cash compensation                          | 2,177    | 2,760    |
| Goodwill and intangibles amortization          | 1,632    | 1,949    |
| Allowance for doubtful accounts                | 208      | 148      |
| Net deferred tax assets                        | 7,054    | 8,210    |
| Deferred tax liabilities:                      |          |          |
| Plant and equipment                            | (1,443 ) | (1,255 ) |
| Intangibles related to the Kasamba acquisition | (206 )   | (718 )   |
| Total deferred tax liabilities                 | (1,649 ) | (1,973 ) |
| Net deferred assets                            | \$ 5,405 | \$ 6,237 |

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(In Thousands, Except Share and per Share Data)****(8) 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 years ended December 31, 2010, 2009 and 2008 was approximately \$6,428, \$4,855 and \$3,297, respectively.

Future minimum lease payments under non-cancelable operating leases (with an initial or remaining lease terms in excess of one year) are as follows:

| Year ending December 31,     | Operating<br>Leases |
|------------------------------|---------------------|
| 2011                         | \$ 7,219            |
| 2012                         | 6,102               |
| 2013                         | 3,387               |
| 2014                         | 2,052               |
| 2015                         | 2,077               |
| Thereafter                   | 2,572               |
| Total minimum lease payments | \$ 23,409           |

**Capital Expenditures**

During 2007, the Company began to build a collocation facility in the eastern U.S. to host the LivePerson and Consumer services. During 2010, the Company began to build additional collocation facilities in Europe to host the LivePerson and Consumer services. Through December 31, 2010, the Company spent approximately \$17,920 for servers, network components and related hardware and software. This amount is included in Assets Property and equipment, net on our December 31, 2010 balance sheet. Though the Company expects to incur additional costs in 2011 related to the continued build-out of our collocation facilities and similar backup facilities to support disaster recovery capabilities in the U.S. and U.K., its total capital expenditures are not currently expected to exceed \$8,000 in 2011. The Company anticipates that our current cash and cash equivalents and cash from operations will be sufficient to complete the build-out.

**Employee Benefit Plans**

The Company has a 401(k) defined contribution plan covering all eligible employees. The Company provides for employer matching contributions equal to 50% of employee contributions, up to the lesser of 5% of eligible compensation or \$6. Matching contributions are deposited in to the employees 401(k) account and are subject to 5 year graded vesting. Salaries and related expenses include \$436 and \$335 of employer matching contributions for the

years ended December 31, 2010 and 2009, respectively.

## **(9) Legal Matters**

On July 31, 2007, the Company was served with a complaint filed in the United States District Court for the Southern District of New York by the Shareholders Representative of Proficient Systems, Inc. In connection with the July 2006 acquisition of Proficient, the Company was contingently required to issue up to 2,050,000 shares of common stock based on the terms of an earn-out provision in the merger agreement. In accordance with the terms of the earn-out provision, the Company issued 1,127,985 shares of LivePerson common stock in the second quarter of 2007 to the former shareholders of Proficient. The amended complaint filed by the Shareholders Representative, or Plaintiff, on May 12, 2009 alleges that the Company breached the merger agreement by failing to properly account for net annualized revenue, and demands payment of damages on the grounds that substantially all of the remaining contingently issuable earn-out shares should have been paid. The Company believes the claims are without merit. The case recently proceeded to trial, which ended on November 4, 2010. Post-trial filings were due on November 19, 2010. In the event that the Court finds in whole or in part for Plaintiff, the Company would be required to pay monetary damages in the

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**LIVEPERSON, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**(9) Legal Matters (continued)**

amount held by the Court to have been underpaid in the earn-out. The Company is presently unable to reasonably estimate the amount of actual damages, if any, that will be awarded by the Court. If the Court were to find in favor of Plaintiff on every claim at issue in the litigation, the maximum potential damages award would be approximately \$6.0 million. Should the Company be required to pay any damages award, the associated payment would be allocated to goodwill in connection with Proficient acquisition.

On January 20, 2011, the Company's patent litigation against InstantService, Inc., together with all related claims and counterclaims, was dismissed pursuant to a settlement agreement entered by the parties. The terms of the settlement are confidential. The settlement of this litigation did not have a material effect on the Company's results of operations, financial condition or cash flows.

On November 3, 2010, Gemini IP LLC filed an amended complaint in a suit pending in the United States District Court for the Eastern District of Texas, adding patent infringement allegations against the Company and various other defendants, including LANDesk Software, Inc., Saba Software, Inc., Genesys S.A. d/b/a Genesys Conferencing, Genesys Conferencing, Inc., Avaya Inc., Best Buy Co., Inc., Bomgar Corporation, ConnectWise, Inc., Elsinore Technologies Inc., GFI Software Ltd., GFI USA, Inc., GFI Software Development, Ltd., LogMeIn, Inc., N-able Technologies Incorporated, NTR Global, Venti Solutions, LLC, Zoho Corporation, Zenith Infotech Ltd., International Business Machines Corp., Samsung Electronics America, Inc., Samsung Electronics Co., Ltd., Samsung Telecommunications America, LLC, AT&T, Inc., Sony Corporation, and Sony Corporation of America. Gemini seeks damages for past infringement, and an injunction against future infringement of the patent in suit. We believe Gemini's claims are without merit. On January 10, 2011, the Company answered the complaint, asserting numerous affirmative defenses including non-infringement and invalidity of the patent in suit, and we also counterclaimed for a declaratory judgment of non-infringement and invalidity of the patent in suit. No schedule for proceedings in this matter has been set by the Court at this time. The Company intends to vigorously defend against Gemini's allegations, and vigorously pursue our counterclaims. The Company has not accrued for this contingency as of December 31, 2010, because the amount of loss, if any, cannot be reasonably estimated at this time.

From time to time, the Company is involved in other legal proceedings arising in the ordinary course of its business.

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

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**LIVEPERSON, INC.**

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(In Thousands, Except Share and per Share Data)**

**(10) Unaudited Supplementary Financial Information    Quarterly  
Results of Operations**

The following table sets forth, for the periods indicated, the Company's financial information for the eight most recent quarters ended December 31, 2010. In the Company's opinion, this unaudited information has been prepared on a basis consistent with the annual consolidated financial statements and includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the unaudited information for the periods presented. This information should be read in conjunction with the consolidated financial statements, including the related notes, included herein.

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**LIVEPERSON, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(In Thousands, Except Share and per Share Data)**

**Item 9. Changes in and Disagreements With Accountants on  
Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Management's Annual Report on Internal Control over Financial  
Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Rule 13a-15(f) promulgated under the Exchange Act. Our internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements. Our management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our internal control over financial reporting as of December 31, 2010 based on the framework established in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's evaluation described above, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

The effectiveness of our internal control over financial reporting as of December 31, 2010 has been audited by BDO USA, LLP, an independent registered public accounting firm. Their attestation is included herein.

**Limitations of the Effectiveness of Internal Control**

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

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2010 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.

## 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 Exchange Act, as of December 31, 2010. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2010 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.

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# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
LivePerson, Inc.  
New York, NY

We have audited LivePerson, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). LivePerson, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, LivePerson, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of LivePerson, Inc.'s as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2010 and our report dated March 15, 2011 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

New York, New York  
March 15, 2011



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**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this Item 10 is incorporated by reference to the sections captioned to Matters to be Considered at Annual Meeting Election of Directors, Executive Officers, Board Committees and Meetings Audit Committee, Codes of Conduct and Corporate Governance Documents and Section 16(a) Beneficial Ownership Reporting Compliance in the definitive proxy statement for our 2011 Annual Meeting of Stockholders.

There have been no changes to the procedures by which stockholders may recommend nominees to our Board of Directors since our last disclosure of such procedures, which appeared in the definitive proxy statement for our 2010 Annual Meeting of Stockholders.

We have adopted a Code of Ethics that applies to our Chief Executive Officer, who is our principal executive officer, and other senior financial officers. Our Code of Ethics is available at: [www.liveperson.com](http://www.liveperson.com) under Investor Relations / Corporate Governance . *The Company's web site address provided above is not intended to function as a hyperlink, and the information on the Company's web site is not and should not be considered part of this Annual Report on Form 10-K and is not incorporated by reference herein.* The Company will post on this website any amendments to our Code of Ethics.

**Item 11. Executive Compensation**

The information required by this Item 11 is incorporated by reference to the sections captioned Compensation Discussion and Analysis, Compensation Committee Report (which information shall be deemed furnished in this Annual Report on Form 10-K), Executive and Director Compensation and Compensation Committee Interlocks and Insider Participation in the definitive proxy statement for our 2011 Annual Meeting of Stockholders.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item 12 with respect to the security ownership of certain beneficial owners and management is incorporated by reference to the section captioned Ownership of Securities in the definitive proxy statement for our 2011 Annual Meeting of Stockholders.

The following table provides certain information regarding the common stock authorized for issuance under our equity compensation plans, as of December 31, 2010:

Plan Category

|   | Number of Securities to Be Issued Upon Exercise of Outstanding Options, (a) | Weighted-Average Price of Outstanding Warrants and Rights (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans <sup>(2)</sup> (c) |
|---|---|---|---|
| Equity compensation plans approved by stockholders <sup>(1)</sup> | 8,819,260   | \$ 5.04   | 6,246,926   |
| Equity compensation plans not approved by stockholders            |   |   |   |
| Total   | 8,819,260   | \$ 5.04   | 6,246,926   |

(1) Our equity compensation plans which were approved by our stockholders are the 2009 Stock Incentive Plan and the 2010 Employee Stock Purchase Plan.

(2) Excludes securities reflected in column (a). Also see Note 5 to our consolidated financial statements.

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## **Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item 13 is incorporated by reference to the sections captioned Certain Relationships and Related Transactions and Director Independence in the definitive proxy statement for our 2011 Annual Meeting of Stockholders.

## **Item 14. Principal Accountant Fees and Services**

The information required by this Item 14 is incorporated by reference to the section captioned Independent Registered Public Accounting Firm Fees and Pre-Approval Policies and Procedures in the definitive proxy statement for our 2011 Annual Meeting of Stockholders.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

The following documents are filed as part of this Annual Report on Form 10-K:

1. Financial Statements.  
Incorporated by reference to the index of consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.
2. Financial Statement Schedules.  
None.
3. Exhibits.  
Incorporated by reference to the Exhibit Index immediately preceding the exhibits attached to this Annual Report on Form 10-K.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on March 15, 2011.

**LIVEPERSON, INC.**

By:

/s/ Robert LoCascio

Name: Robert P. LoCascio

Title: Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 15, 2011.

| Signature                                  | Title(s)  |
|--|---|
| /s/ Robert P. LoCascio                     | Chief Executive Officer and Chairman of the Board of Directors<br>(Principal Executive Officer) |
| Robert P. LoCascio<br>/s/ Timothy E. Bixby | President, Chief Financial Officer and Director<br>(Principal Financial and Accounting Officer) |
| Timothy E. Bixby<br>/s/ Steven Berns       | Director  |
| Steven Berns<br>/s/ Peter Block            | Director  |
| Peter Block<br>/s/ Kevin C. Lavan          | Director  |
| Kevin C. Lavan<br>/s/ William G. Wesemann  | Director  |
| William G. Wesemann                        |   |

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**EXHIBIT INDEX**

| Number  | Description   |
|---------|---|
| 2.1     | Agreement and Plan of Merger, dated as of June 22, 2006, among LivePerson, Inc., Soho Acquisition Corp., Proficient Systems, Inc. and Gregg Freishtat as Shareholders Representative (incorporated by reference to the identically numbered exhibit in the Current Report on Form 8-K filed on June 22, 2006)           |
| 3.1     | Fourth Amended and Restated Certificate of Incorporation (incorporated by reference to the identically-numbered exhibit to LivePerson's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and filed March 30, 2001 (the 2000 Form 10-K))   |
| 3.2     | Second Amended and Restated Bylaws, as amended (incorporated by reference to the identically-numbered exhibit to the 2000 Form 10-K)  |
| 4.1     | Specimen common stock certificate (incorporated by reference to the identically-numbered exhibit to LivePerson's Registration Statement on Form S-1, as amended (Registration No. 333-96689) (Registration No. 333-96689))  |
| 4.2     | Second Amended and Restated Registration Rights Agreement, dated as of January 27, 2000, by and among LivePerson, the several persons and entities named on the signature pages thereto as Investors, and Robert LoCascio (incorporated by reference to the identically-numbered exhibit to Registration No. 333-96689) |
| 10.1    | 2009 Stock Incentive Plan (incorporated by reference to Exhibit 99.1 to LivePerson's Registration Statement on Form S-8 filed on June 9, 2009)*   |
| 10.2    | LivePerson, Inc. 2010 Employee Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to the LivePerson's Registration Statement on Form S-8 filed on August 19, 2010)*   |
| 10.3    | Employment Agreement between LivePerson and Robert P. LoCascio, dated as of January 1, 1999 (incorporated by reference to Exhibit 10.1 to Registration No. 333-96689)*  |
| 10.4(a) | Employment Agreement between LivePerson and Timothy E. Bixby, dated as of June 23, 1999 (incorporated by reference to Exhibit 10.3 to Registration No. 333-96689)*  |
| 10.4(b) | Modification to Employment Agreement between LivePerson and Timothy E. Bixby, dated as of April 1, 2003 (incorporated by reference to Exhibit 10.2.1 to LivePerson's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 and filed August 13, 2003)*  |
| 10.4(c) | Separation Agreement and General Release between LivePerson and Timothy E. Bixby, dated as of November 2, 2010*   |
| 21.1    | Subsidiaries  |
| 23.1    | Consent of BDO USA, LLP   |
| 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   |

\* Management contract or compensatory plan or arrangement