

LIVEPERSON INC  
Form 10-Q  
November 09, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended SEPTEMBER 30, 2012**

**or**

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

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

**Commission file number: 000-30141**

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

**DELAWARE**  
(State or Other Jurisdiction of

**13-3861628**  
(IRS Employer Identification No.)

Incorporation or Organization)

**475 TENTH AVENUE, 5th FLOOR**

**10018**

**NEW YORK, NEW YORK**

(Address of Principal Executive Offices) (Zip Code)

**(212) 609-4200**

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of November 2, 2012, 55,868,192 shares of the registrant's common stock were outstanding.

**LIVEPERSON, INC.**

**SEPTEMBER 30, 2012**

**FORM 10-Q**

**INDEX**

|  | PAGE |
|--|------|
| PART I.FINANCIAL INFORMATION   | 4    |
| ITEM 1. FINANCIAL STATEMENTS   | 4    |
| CONDENSED CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2012<br>(UNAUDITED) AND DECEMBER 31, 2011                                    | 4    |
| UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE<br>AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011               | 5    |
| UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME<br>FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011 | 6    |
| UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE<br>NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011                     | 7    |
| NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS   | 8    |
| ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND<br>RESULTS OF OPERATIONS                                       | 19   |
| ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK   | 29   |
| ITEM 4. CONTROLS AND PROCEDURES  | 30   |
| PART II. OTHER INFORMATION   | 31   |
| ITEM 1. LEGAL PROCEEDINGS  | 31   |
| ITEM 1A. RISK FACTORS  | 31   |
| UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS  | 32   |

ITEM  
2.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES 32

ITEM 4. MINE SAFETY DISCLOSURES 32

ITEM 5. OTHER INFORMATION 32

ITEM 6. EXHIBITS 33

2

## **FORWARD-LOOKING STATEMENTS**

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

**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****LIVEPERSON, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)**

|   | September 30, 2012<br>(Unaudited) | December 31, 2011<br>(Note 1(B)) |
|---|-----------------------------------|----------------------------------|
| <b>ASSETS</b>   |                                   |                                  |
| Current assets:   |                                   |                                  |
| Cash and cash equivalents   | \$ 103,284                        | \$ 93,278                        |
| Accounts receivable, net of allowance for doubtful accounts of \$708 and \$688 as of September 30, 2012 and December 31, 2011, respectively | 22,825                            | 20,999                           |
| Prepaid expenses and other current assets   | 6,921                             | 5,390                            |
| Deferred tax assets, net  | 2,588                             | 2,342                            |
| Total current assets  | 135,618                           | 122,009                          |
| Property and equipment, net   | 16,124                            | 13,879                           |
| Intangibles, net  | 12,367                            | 1,095                            |
| Goodwill  | 26,572                            | 24,090                           |
| Deferred tax assets, net  | 3,621                             | 2,829                            |
| Deferred implementation costs, net of current   | 215                               | 247                              |
| Security deposits   | 551                               | 356                              |
| Other assets  | 1,465                             | 1,546                            |
| Total assets  | \$ 196,533                        | \$ 166,051                       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                   |                                  |
| Current liabilities:  |                                   |                                  |
| Accounts payable  | \$ 9,908                          | \$ 8,258                         |
| Accrued expenses  | 14,056                            | 12,019                           |
| Deferred revenue  | 6,752                             | 5,378                            |
| Total current liabilities   | 30,716                            | 25,655                           |
| Deferred revenue, net of current  | 1,152                             | 1,152                            |
| Other liabilities   | 1,465                             | 1,546                            |
| Total liabilities   | 33,333                            | 28,353                           |
| Commitments and contingencies   |                                   |                                  |
| Stockholders' equity:   |                                   |                                  |

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|   |            |   |            |   |
|---|------------|---|------------|---|
| Preferred stock, \$.001 par value per share; 5,000,000 shares authorized, 0 shares issued and outstanding at September 30, 2012 and December 31, 2011   | —          |   | —          |   |
| Common stock, \$.001 par value per share; 100,000,000 shares authorized, 55,845,337 shares issued and outstanding at September 30, 2012 and 54,090,344 shares issued and outstanding at December 31, 2011 | 56         |   | 54         |   |
| Additional paid-in capital  | 246,906    |   | 226,113    |   |
| Accumulated deficit   | (83,272)   | ) | (88,135)   | ) |
| Accumulated other comprehensive loss  | (490)      | ) | (334)      | ) |
| Total stockholders' equity  | 163,200    |   | 137,698    |   |
| Total liabilities and stockholders' equity  | \$ 196,533 |   | \$ 166,051 |   |

**SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED**

**CONSOLIDATED FINANCIAL STATEMENTS.**

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

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2012                                | 2011       | 2012                               | 2011       |
| Revenue  | \$39,670                            | \$34,347   | \$114,934                          | \$96,581   |
| Operating expenses:  |                                     |            |                                    |            |
| Cost of revenue  | 9,036                               | 8,368      | 25,450                             | 25,148     |
| Product development  | 8,005                               | 5,266      | 21,881                             | 14,658     |
| Sales and marketing  | 12,713                              | 9,907      | 36,820                             | 28,146     |
| General and administrative   | 7,316                               | 5,689      | 22,784                             | 15,037     |
| Amortization of intangibles  | 11                                  | 11         | 98                                 | 32         |
| Total operating expenses   | 37,081                              | 29,241     | 107,033                            | 83,021     |
| Income from operations   | 2,589                               | 5,106      | 7,901                              | 13,560     |
| Other income (expense):  |                                     |            |                                    |            |
| Financial income (expense)   | 22                                  | (780)      | 99                                 | (418)      |
| Interest income  | 19                                  | 18         | 56                                 | 48         |
| Total other income (expense), net  | 41                                  | (762)      | 155                                | (370)      |
| Income before provision for income taxes   | 2,630                               | 4,344      | 8,056                              | 13,190     |
| Provision for income taxes   | 1,030                               | 1,609      | 3,193                              | 5,028      |
| Net income   | \$1,600                             | \$2,735    | \$4,863                            | \$8,162    |
| Basic net income per common share  | \$0.03                              | \$0.05     | \$0.09                             | \$0.16     |
| Diluted net income per common share  | \$0.03                              | \$0.05     | \$0.09                             | \$0.15     |
| Weighted average shares outstanding used in basic net<br>income per common share calculation   | 55,688,824                          | 53,109,824 | 55,087,109                         | 52,642,700 |
| Weighted average shares outstanding used in diluted net<br>income per common share calculation | 57,760,868                          | 55,736,089 | 56,987,302                         | 55,240,235 |

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





**LIVEPERSON, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(IN THOUSANDS)**

**UNAUDITED**

|   | Three Months Ended |          | Nine Months Ended |          |
|---|--------------------|----------|-------------------|----------|
|   | September 30,      |          | September 30,     |          |
|   | 2012               | 2011     | 2012              | 2011     |
| Net income                              | \$ 1,600           | \$ 2,735 | \$ 4,863          | \$ 8,162 |
| Foreign currency translation adjustment | (200 )             | 25       | (156 )            | (4 )     |
| Comprehensive income                    | \$ 1,400           | \$ 2,760 | \$ 4,707          | \$ 8,158 |

**SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED**

**CONSOLIDATED FINANCIAL STATEMENTS.**

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

|   | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2012                               | 2011     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                    |          |
| Net income  | \$4,863                            | \$8,162  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |          |
| Stock-based compensation expense  | 7,646                              | 4,951    |
| Depreciation  | 5,170                              | 4,929    |
| Amortization of intangibles   | 294                                | 953      |
| Deferred income taxes   | (1,325 )                           | (58 )    |
| Provision for doubtful accounts, net  | 20                                 | 230      |
| <b>CHANGES IN OPERATING ASSETS AND LIABILITIES:</b>                               |                                    |          |
| Accounts receivable   | (1,846 )                           | (3,434 ) |
| Prepaid expenses and other current assets   | (1,617 )                           | 2,080    |
| Deferred implementation costs   | 31                                 | (66 )    |
| Security deposits   | (193 )                             | 146      |
| Other assets  | —                                  | 116      |
| Accounts payable  | 1,129                              | 470      |
| Accrued expenses  | 2,121                              | (1,881 ) |
| Deferred revenue  | 1,373                              | 849      |
| Net cash provided by operating activities   | 17,666                             | 17,447   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                    |          |
| Purchases of property and equipment, including capitalized software               | (6,919 )                           | (6,156 ) |
| Acquisition of Look.io, net of cash acquired                                      | (900 )                             | —        |
| Acquisition of Amadesa technology assets  | (10,798 )                          | —        |
| Acquisition of Proficient   | (77 )                              | (75 )    |
| Net cash used in investing activities   | (18,694 )                          | (6,231 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                                    |          |
| Excess tax benefit from the exercise of employee stock options                    | 2,607                              | 1,447    |
| Proceeds from issuance of common stock in connection with the exercise of options | 8,557                              | 6,886    |
| Net cash provided by financing activities   | 11,164                             | 8,333    |
| Effect of foreign exchange rate changes on cash and cash equivalents              | (130 )                             | (23 )    |
| Net increase in cash and cash equivalents   | 10,006                             | 19,526   |
| Cash and cash equivalents at the beginning of the period                          | 93,278                             | 61,336   |

|  |            |           |
|--|------------|-----------|
| Cash and cash equivalents at the end of the period | \$ 103,284 | \$ 80,862 |
|--|------------|-----------|

Supplemental disclosure of non-cash investing activities:

During the nine months ended September 30, 2012, the Company issued 109,517 shares of common stock, valued at \$1,984, in connection with the acquisition of Look.io on June 13, 2012.

Cash flows from investing activities for the nine months ended September 30, 2012 and September 30, 2011 does not include the purchase of approximately \$1,952 and \$676, respectively, of capitalized equipment related to the Company's co-location facilities because the corresponding invoices are included in accounts payable for the corresponding nine month period, and therefore did not have an impact on cash flows.

During the nine months ended September 30, 2012 and 2011, total net cash paid for income taxes was \$1,556 and \$1,804, respectively.

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

**LIVEPERSON, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)**

**(1) SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES**

**(A) SUMMARY OF OPERATIONS**

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

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

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

LivePerson was incorporated in the State of Delaware in November 1995 and the LivePerson service was introduced in November 1998. In April 2000, the company completed an initial public offering and is currently traded on the Nasdaq and the Tel Aviv Stock Exchange. LivePerson is headquartered in New York City with offices in Atlanta, San Francisco, London, Melbourne, and Tel Aviv.

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

The accompanying condensed consolidated financial statements as of September 30, 2012 and for the three and nine months ended September 30, 2012 and 2011 are unaudited. In the opinion of management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the consolidated financial position of LivePerson as of September 30, 2012, and the consolidated results of operations, comprehensive income and cash flows for the interim periods ended September 30, 2012 and 2011. The financial data and other information disclosed in these notes to the condensed consolidated financial statements related to these periods are unaudited. The results of operations for any interim period are not necessarily indicative of the results of operations for any other future interim period or for a full fiscal year. The condensed consolidated balance sheet at December 31, 2011 has been derived from audited consolidated financial statements at that date.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2011, included in the Company's Annual Report on Form 10-K filed with the SEC on March 13, 2012.

## **(C) REVENUE RECOGNITION**

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

For certain of the Company's larger customers, the Company may provide call center labor through an arrangement with one or more of several qualified vendors. For most of these customers, the Company passes the fee it incurs with the labor provider and its fee for the hosted services through to its customers in the form of a fixed fee for each order placed via the Company's online engagement solutions. For these Pay for Performance ("PFP") arrangements, the Company recognizes revenue net of the labor provider's fee in accordance with ASC 605-45, "Principal Agent Considerations," due primarily to the fact that the call center labor vendor is the primary obligor with respect to the labor services provided. Additionally, the Company performs as an agent without risk of loss for collection and does not bear inventory risk with respect to the outsourced labor services. Finally, the Company does not provide any part of the labor services, has no latitude in establishing prices for the labor services and generally does not have discretion in selecting the vendor.

The majority of the Company's larger customers 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 customer relationship upon commencement of the hosting services. The Company may also charge professional service fees related to additional training, business consulting and analysis in support of the LivePerson services.

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

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

#### **(D) STOCK-BASED COMPENSATION**

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



The following table summarizes stock-based compensation expense related to employee stock options under ASC 718-10 included in Company's Statements of Income for the three and nine months ended September 30, 2012 and 2011:

|   | Three Months Ended |          | Nine Months Ended |          |
|---|--------------------|----------|-------------------|----------|
|   | September 30,      |          | September 30,     |          |
|   | 2012               | 2011     | 2012              | 2011     |
| Cost of revenue   | \$ 428             | \$ 212   | \$ 1,130          | \$ 758   |
| Product development expense                                   | 807                | 417      | 2,206             | 1,299    |
| Sales and marketing expense                                   | 822                | 427      | 2,113             | 1,206    |
| General and administrative expense                            | 795                | 680      | 2,197             | 1,688    |
| Total stock based compensation included in operating expenses | \$ 2,852           | \$ 1,736 | \$ 7,646          | \$ 4,951 |

The per share weighted average fair value of stock options granted during the three and nine months ended September 30, 2012 was \$8.78 and \$8.23, respectively. The per share weighted average fair value of stock options granted during the three and nine months ended September 30, 2011 was \$5.91 and \$6.45, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                          | Three Months Ended |                | Nine Months Ended |                |
|--------------------------|--------------------|----------------|-------------------|----------------|
|                          | September 30,      |                | September 30,     |                |
|                          | 2012               | 2011           | 2012              | 2011           |
| Dividend yield           | 0.0 %              | 0.0 %          | 0.0 %             | 0.0 %          |
| Risk-free interest rate  | 0.58% - 0.62 %     | 0.9% - 1.5 %   | 0.58% - 0.87 %    | 0.9% - 3.7 %   |
| Expected life (in years) | 5.0                | 5.0            | 5.0               | 5.0            |
| Historical volatility    | 59.7% - 60.3 %     | 60.1% - 60.6 % | 59.7% - 60.8 %    | 60.1% - 61.5 % |

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

The Company established the 2009 Stock Incentive Plan (as amended and restated, the "2009 Plan") as a successor to the 2000 Plan. Under the 2009 Plan, the options which had been outstanding under the 2000 Plan were incorporated into the 2009 Plan and the Company increased the number of shares available for issuance under the plan by 6,000,000. The Company amended the 2009 stock incentive plan (the "Amended 2009 Plan") effective June 7, 2012.

The Amended 2009 Plan increased the number of shares authorized for issuance under the plan by an additional 4,250,000, thereby reserving for issuance 23,817,744 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have ten-year terms. As of September 30, 2012, approximately 11,237,000 shares of common stock were reserved for issuance under the 2009 Plan (taking into account all option exercises through September 30, 2012). As of September 30, 2012, there was approximately \$42,178 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of approximately 2.2 years.

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 September 30, 2012, approximately 880,000 shares of common stock were reserved for issuance under the Employee Stock Purchase Plan (taking into account all share purchases through September 30, 2012).

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

|   | Options     | Weighted<br>Average<br>Exercise Price |
|---|-------------|---------------------------------------|
| Options outstanding at December 31, 2011  | 8,843,413   | \$ 7.91                               |
| Options granted                           | 3,147,200   | 16.24                                 |
| Options exercised                         | (1,578,890) | 5.05                                  |
| Options cancelled                         | (523,973 )  | 9.82                                  |
| Options outstanding at September 30, 2012 | 9,887,750   | 10.92                                 |
| Options exercisable at September 30, 2012 | 3,074,922   | \$ 6.41                               |

The total value of stock options exercised during the nine months ended September 30, 2012 was approximately \$15,792. The total intrinsic value of options exercisable at September 30, 2012 was approximately \$35,564. The total intrinsic value of nonvested options at September 30, 2012 is approximately \$35,222. The total intrinsic value of all outstanding options at September 30, 2012 is \$70,786.

A summary of the status of the Company's nonvested shares as of December 31, 2011, and changes during the nine months ended September 30, 2012 is as follows:

|  | Options     | Weighted<br>Average Grant-<br>Date Fair Value |
|--|-------------|---|
| Nonvested Shares at December 31, 2011  | 6,038,014   | \$ 5.04                                       |
| Granted                                | 3,147,200   | 8.23  |
| Vested                                 | (1,853,038) | 4.40  |
| Cancelled                              | (519,348 )  | 5.22  |
| Nonvested Shares at September 30, 2012 | 6,812,828   | \$ 6.71                                       |

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

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

Diluted net income per common share for the three and nine months ended September 30, 2012 includes the effect of options to purchase 5,413,038 and 5,015,988 shares, respectively, of common stock with a weighted average exercise price of \$7.20 and \$6.82, respectively. Diluted net income per common share for the three and nine months ended September 30, 2011 includes the effect of options to purchase 6,385,454 and 6,186,954 shares, respectively, of common stock with a weighted average exercise price of \$4.85 and \$4.73, respectively.

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

|                                     | Three Months Ended |            | Nine Months Ended |            |
|-------------------------------------|--------------------|------------|-------------------|------------|
|                                     | September 30,      |            | September 30,     |            |
|                                     | 2012               | 2011       | 2012              | 2011       |
| Basic                               | 55,688,824         | 53,109,824 | 55,087,109        | 52,642,700 |
| Effect of assumed exercised options | 2,072,044          | 2,626,265  | 1,900,193         | 2,597,535  |
| Diluted                             | 57,760,868         | 55,736,089 | 56,987,302        | 55,240,235 |

**(F) SEGMENT REPORTING**

The Company accounts for its segment information in accordance with the provisions of ASC 280-10, "Segment Reporting." ASC 280-10 establishes annual and interim reporting standards for operating segments of a company. ASC 280-10 requires disclosures of selected segment-related financial information about products, major customers, and geographic areas based on the Company's internal accounting methods. The Company is organized into two operating segments for purposes of making operating decisions and assessing performance. The Business segment facilitates real-time online interactions – chat, voice, and content delivery across multiple channels and screens for global corporations of all sizes. The Consumer segment facilitates online transactions between Experts and Users and sells its services to consumers. Both segments currently generate their revenue primarily in the 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 inter-segment sales.

Summarized financial information by segment for the three months ended September 30, 2012, 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     | \$ 33,245    | \$—        | \$33,245 | \$—      |
| Hosted services - Consumer     | 3,577        | —          | —        | 3,577    |
| Professional services          | 2,848        | —          | 2,848    | —        |
| Total revenue                  | 39,670       | —          | 36,093   | 3,577    |
| Cost of revenue                | 9,036        | —          | 8,539    | 497      |
| Sales and marketing            | 12,713       | —          | 11,502   | 1,211    |
| Amortization of intangibles    | 11           | —          | 11       | —        |
| Unallocated corporate expenses | 15,321       | 15,321     | —        | —        |
| Operating income (loss)        | \$ 2,589     | \$(15,321) | \$16,041 | \$ 1,869 |

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

|                            | Consolidated | Corporate | Business | Consumer |
|----------------------------|--------------|-----------|----------|----------|
| Revenue:                   |              |           |          |          |
| Hosted services - Business | \$ 29,171    | \$—       | \$29,171 | \$—      |
| Hosted services - Consumer | 3,561        | —         | —        | 3,561    |

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|                                |          |             |           |          |
|--------------------------------|----------|-------------|-----------|----------|
| Professional services          | 1,615    | —           | 1,615     | —        |
| Total revenue                  | 34,347   | —           | 30,786    | 3,561    |
| Cost of revenue                | 8,368    | —           | 7,447     | 921      |
| Sales and marketing            | 9,907    | —           | 8,390     | 1,517    |
| Amortization of intangibles    | 11       | —           | 11        | —        |
| Unallocated corporate expenses | 10,955   | 10,955      | —         | —        |
| Operating income (loss)        | \$ 5,106 | \$(10,955 ) | \$ 14,938 | \$ 1,123 |

12

Revenues attributable to domestic and foreign operations for the three months ended September 30, 2012 and 2011, follows:

|                 | September 30, |          |
|-----------------|---------------|----------|
|                 | 2012          | 2011     |
| United States   | \$29,531      | \$25,873 |
| United Kingdom  | 5,898         | 4,958    |
| Other countries | 4,241         | 3,516    |
| Total revenue   | \$39,670      | \$34,347 |

Summarized financial information by segment for the nine months ended September 30, 2012, 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     | \$ 96,634    | \$—         | \$96,634 | \$—      |
| Hosted services - Consumer     | 11,387       | —           | —        | 11,387   |
| Professional services          | 6,913        | —           | 6,913    | —        |
| Total revenue                  | 114,934      | —           | 103,547  | 11,387   |
| Cost of revenue                | 25,450       | —           | 23,845   | 1,605    |
| Sales and marketing            | 36,820       | —           | 32,616   | 4,204    |
| Amortization of intangibles    | 98           | —           | 98       | —        |
| Unallocated corporate expenses | 44,665       | 44,665      | —        | —        |
| Operating income (loss)        | \$ 7,901     | \$(44,665 ) | \$46,988 | \$ 5,578 |

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

|                                | Consolidated | Corporate   | Business | Consumer |
|--------------------------------|--------------|-------------|----------|----------|
| Revenue:                       |              |             |          |          |
| Hosted services - Business     | \$ 81,493    | \$—         | \$81,493 | \$—      |
| Hosted services - Consumer     | 10,954       | —           | —        | 10,954   |
| Professional services          | 4,134        | —           | 4,134    | —        |
| Total revenue                  | 96,581       | —           | 85,627   | 10,954   |
| Cost of revenue                | 25,148       | —           | 22,322   | 2,826    |
| Sales and marketing            | 28,146       | —           | 23,527   | 4,619    |
| Amortization of intangibles    | 32           | —           | 32       | —        |
| Unallocated corporate expenses | 29,695       | 29,695      | —        | —        |
| Operating income (loss)        | \$ 13,560    | \$(29,695 ) | \$39,746 | \$ 3,509 |

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Revenues attributable to domestic and foreign operations for the nine months ended September 30, 2012 and 2011, follows:

|                 | September 30, |          |
|-----------------|---------------|----------|
|                 | 2012          | 2011     |
| United States   | \$86,909      | \$73,820 |
| United Kingdom  | 16,017        | 12,953   |
| Other countries | 12,008        | 9,808    |
| Total revenue   | \$114,934     | \$96,581 |



Long-lived assets by geographic region follows:

|                         | September 30, 2012 | December 31, 2011 |
|-------------------------|--------------------|-------------------|
| United States           | \$ 34,378          | \$ 28,626         |
| Israel                  | 23,750             | 13,167            |
| United Kingdom          | 2,787              | 2,249             |
| Total long-lived assets | \$ 60,915          | \$ 44,042         |

### (G) GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the nine months ended September 30, 2012 are as follows:

|  | Total    | Business  | Consumer |
|--|----------|-----------|----------|
| Balance as of December 31, 2011          | \$24,090 | \$ 16,066 | \$ 8,024 |
| Adjustments to goodwill:                 |          |           |          |
| Look.io acquisition (see Note 3)         | 2,405    | 2,405     | —        |
| Contingent earnout payments (see Note 3) | 77       | 77        | —        |
| Balance as of September 30, 2012         | \$26,572 | \$ 18,548 | \$ 8,024 |

The changes in the carrying amount of goodwill for the year ended December 31, 2011 are as follows:

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

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

### Acquired Intangible Assets

| As of September 30, 2012 |                  |                          |
|--------------------------|------------------|--------------------------|
| Gross Carrying           | Weighted Average | Accumulated Amortization |

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|                               | Amount   | Amortization<br>Period |          |
|-------------------------------|----------|------------------------|----------|
| Amortizing intangible assets: |          |                        |          |
| Technology                    | \$17,765 | 3.8 years              | \$ 5,738 |
| 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             | 135      |
| Other                         | 235      | 3.0 years              | 235      |
| Total                         | \$21,915 |                        | \$ 9,548 |

As of December 31, 2011

|                               | Gross<br>Carrying<br>Amount | Weighted<br>Average<br>Amortization<br>Period | Accumulated<br>Amortization |
|-------------------------------|-----------------------------|---|-----------------------------|
| Amortizing intangible assets: |                             |   |                             |
| Technology                    | \$6,199                     | 3.8 years                                     | \$ 5,474                    |
| 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                                    | 105                         |
| Other                         | 235                         | 3.0 years                                     | 235                         |
| Total                         | \$10,349                    |   | \$ 9,254                    |

Amortization expense is calculated on a straight-line basis over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was \$140 and \$294 for the three and nine months ended September 30, 2012, respectively, and \$318 and \$953 for the three and nine months ended September 30, 2011, respectively. Estimated amortization expense for the next five years is: \$141 in 2012, \$3,261 in 2013, \$3,196 in 2014, \$2,870 in 2015, \$2,743 in 2016 and \$156 thereafter.

#### **(H) RECENTLY ISSUED ACCOUNTING STANDARDS**

In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles—Goodwill and Other, General Intangibles Other than Goodwill. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. The Company elected early adoption of this update and it had no impact on its consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. This ASU is intended to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities within the scope of this update. The amendments require enhanced disclosures by requiring improved

information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. An entity is required to apply this amendment for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. ASU No. 2011-11 relates specifically to disclosures, it will not have an impact on the Company's consolidated financial statements.

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

**(2) BALANCE SHEET COMPONENTS*****Property and Equipment***

Property and equipment is summarized as follows:

|  | September 30, 2012 | December 31, 2011 |
|--|--------------------|-------------------|
| Computer equipment and software                | \$ 36,023          | \$ 30,182         |
| Furniture, equipment and building improvements | 5,930              | 4,356             |
|  | 41,953             | 34,538            |
| Less accumulated depreciation                  | 25,829             | 20,659            |
| Total  | \$ 16,124          | \$ 13,879         |

***Accrued Expenses***

Accrued expenses consist of the following:

|  | September 30, 2012 | December 31, 2011 |
|--|--------------------|-------------------|
| Payroll and other employee related costs                   | \$ 7,336           | \$ 6,435          |
| Professional services and consulting and other vendor fees | 5,999              | 4,686             |
| Sales commissions  | 378                | 446               |
| Other  | 343                | 452               |
| Total  | \$ 14,056          | \$ 12,019         |

**(3) ACQUISITIONS*****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 amount of the net asset was allocated to “Intangibles, net.”

*Amadesa Ltd.*

On May 31, 2012, the Company acquired technology assets from Amadesa, Ltd., an Israeli-based start-up, for aggregate cash consideration of approximately \$10,301. The acquisition provides the Company with sophisticated, machine-learning predictive modeling that it expects to leverage across multiple engagement channels, enhancing its real-time intelligent engagement platform. The asset was allocated to “Intangibles, net” on the Company’s September 30, 2012, balance sheet and will be amortized over its expected period of benefit. The acquisition did not have a material impact on the Company’s reported operating results. Total acquisition costs incurred in the nine months ended September 30, 2012 were approximately \$497 and are included in “Intangibles, net” on the Company’s September 30, 2012, balance sheet.

*Look.io*

On June 13, 2012, the Company acquired Look.io, a start-up that provides mobile engagement solutions. The transaction was accounted for under the purchase method of accounting and, accordingly, the operating results of Look.io were included in the Company’s consolidated results of operations from the date of acquisition. The acquisition did not have a material impact on the Company’s reported operating results.

The purchase price was approximately \$2,884, which included the issuance of 109,517 shares of the Company’s common stock valued at approximately \$1,984, based on the quoted market price of the Company’s common stock on the day of closing, and a cash payment of \$900. Total acquisition costs incurred in the nine months ended September 30, 2012 were approximately \$157 and are included in general and administrative expenses in the Company’s Consolidated Statements of Income for the same period. The acquisition did not have a material impact on the Company’s reported operating results. The acquisition adds plug-and-play mobile engagement capabilities to LivePerson’s platform allowing its customers to connect with consumers on mobile devices. All 109,517 shares are included in the weighted average shares outstanding used in basic and diluted net income per share as of the acquisition date. The purchase price was allocated based on management’s estimate of fair values, taking into account all relevant information available. A substantial amount of the purchase price was allocated to intangibles (technology) and the excess was allocated to goodwill. The intangible asset is being amortized over its expected period of benefit. In addition to the purchase price, certain founders can earn additional compensation by achieving an employment milestone. The Company is accruing this contingent compensation ratably over the requisite employment period.

Management’s allocation of the purchase price in connection with the Look.io acquisition is as follows:

|                                    |         |
|------------------------------------|---------|
| Intangible assets (technology)     | \$767   |
| Goodwill                           | 2,405   |
|                                    | 3,172   |
| Deferred tax liability             | (288 )  |
| Total purchase price consideration | \$2,884 |

#### (4) FAIR VALUE MEASUREMENTS

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

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

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

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and certain accrued expenses approximate fair value because of their short-term maturity. On a nonrecurring basis, the Company uses fair value measures when analyzing asset impairment. Long-lived tangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If it is determined such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization periods, their carrying values are reduced to estimated fair value. The Company uses an income approach and inputs that constitute level 3. During the third quarter of each year, the Company evaluates goodwill for impairment at the reporting unit level. The Company uses a combination of discounted cash flows and other qualitative factors in accordance with ASU No. 2011-08 to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This measurement is classified based on level 3 input.



## **(5) COMMITMENTS AND CONTINGENCIES**

The Company leases facilities and certain equipment under agreements accounted for as operating leases. These leases generally require the Company to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the three and nine months ended September 30, 2012 was approximately \$1,972 and \$5,317, respectively. Rental expense for operating leases for the three and nine months ended September 30, 2011 was approximately \$1,613 and \$5,078, respectively.

### *Employee Benefit Plans*

The Company has a 401(k) defined contribution plan covering all eligible employees. The Company provides for employer matching contributions equal to 50% of employee contributions, up to the lesser of 5% of eligible compensation or \$6. Matching contributions are deposited in to the employees 401(k) account and are subject to 5 year graded vesting. Salaries and related expenses include \$182 and \$545 of employer matching contributions for the three and nine months ended September 30, 2012, respectively. Salaries and related expenses include \$135 and \$431 of employer matching contributions for the three and nine months ended September 30, 2011, respectively.

## **(6) LEGAL MATTERS**

On June 15, 2011, the Company filed suit against Lodsys, LLC, in the United States District Court for the Northern District of Illinois, seeking a declaratory judgment that the Company's products do not infringe four patents which Lodsys had previously asserted were infringed by the Company's customers, as well as a declaratory judgment that those four patents are invalid; that case was transferred to the Eastern District of Wisconsin on October 25, 2011, based on a joint motion filed by the parties. On July 5, 2011, Lodsys countersued the Company and other plaintiffs in similarly-situated declaratory judgment actions, including DriveTime Automotive Group, Inc., ESET, LLC, ForeSee Results, LLC, OpinionLab, Inc., and The New York Times Company, in the United States District Court for the Eastern District of Texas. In the Texas case, Lodsys alleged that the Company infringes two of the patents involved in the co-pending declaratory judgment case, and sought damages for past infringement, and an injunction against future infringement. In July 2012, the parties reached a mutual, confidential agreement resolving all claims and counterclaims against each party. The terms of the agreement did not have a material impact on the Company's ongoing operations. All pending claims asserted in both litigations were dismissed with prejudice by the parties in August 2012, ending the Company's involvement in those cases.

On February 7, 2012, the Company filed suit against Pragmatius Telecom LLC in the District of Delaware, seeking a declaratory judgment that the Company's products do not infringe three patents owned by Pragmatius which Pragmatius had previously asserted were infringed by certain of the Company's customers. On March 13, 2012, the Company

amended its complaint to add a request for a declaratory judgment that those three patents are invalid. On April 6, 2012, Pragmatius answered the Amended Complaint, and asserted counterclaims against the Company asserting infringement of the same three patents. Pursuant to a June 1, 2012 Scheduling Order entered by the Court, trial in this matter will begin on or after September 8, 2014. Although the Company currently does not expect that the outcome of this matter will have a material adverse effect on its financial condition or results of operations, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered, that could adversely affect the Company's operating results or cash flows in a particular period.

On September 14, 2012, Community United IP, LLC filed a patent infringement case against the Company, along with co-defendants 1-800-Flowers.com, Discover Card Services, Inc., EarthLink, Inc., QVC, Inc., and Cellco Partnership d/b/a Verizon Wireless based on the co-defendants' alleged use of technology supplied by the Company, in the District of Delaware. Defendants' answers or other pleadings responding to the complaint are currently due on November 8, 2012. The Company currently does not expect that the outcome of this matter will have a material adverse effect on its financial condition or results of operations, however, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered that could adversely affect the Company's operating results or cash flows in a particular period.

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

From time to time, the Company is involved in other legal proceedings arising in the ordinary course of its business, which may arise from, among other things, direct legal claims brought by or against the Company, or from claims brought against the Company's customers for which the Company has a contractual indemnification obligation.

## **(7) SUBSEQUENT EVENT**

On November 6, 2012, the Company signed a definitive agreement to acquire ENGAGE Pty Ltd., an Australian provider of cloud-based customer contact solutions. LivePerson will pay cash at the closing and potentially issue shares of its common stock if certain financial performance targets during the twelve months following the closing of the transaction are achieved. The agreement contains customary representations, warranties and covenants of the parties as well as conditions to closing, including, among other things, receipt of third party consents. The acquisition is expected to close by the end of November 2012. This transaction will be accounted for as a business combination. The Company has not yet completed the accounting for the acquisition; however, management expects that the majority of the purchase price will be allocated to goodwill and other identifiable intangible assets.



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

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

***GENERAL***

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

## **OVERVIEW**

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

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

*Expanding Business with Existing Customers and Adding New Customers.* We are expanding our sales capacity by adding enterprise and midmarket sales agents. We have also expanded our efforts to retain existing SMB customers through increased interaction with them during the early stages of their usage of our services.

*Introducing New Products and Capabilities.* We continue to invest in product marketing, research and development and executive personnel to support our expanding efforts to build and launch new products and capabilities to support existing customer deployments, and to further penetrate our total addressable market. These investments have initially been focused in the areas of online marketing engagement and chat transcript text analysis. Over time, we expect to develop and launch additional capabilities that leverage our existing market position as a leader in proactive, intelligence-driven online engagement.

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

## **THIRD QUARTER 2012**

Financial overview of the three months ended September 30, 2012 compared to the three months ended September 2011:

Total revenue increased 16% to \$39.7 million from \$34.3 million.

Revenue from our Business segment increased 17% to \$36.1 million from \$30.8 million.

Gross profit margin increased to 77% from 76%.

Operating expenses increased 27% to \$37.1 million from \$29.2 million.

Net income decreased 41% to \$1.6 million from \$2.7 million.

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

### ***REVENUE RECOGNITION***

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

For certain of our larger customers, we may provide call center labor through an arrangement with one or more of several qualified vendors. For most of these customers, we pass the fee we incur with the labor provider and our fee for the hosted services through to our customers in the form of a fixed fee for each order placed via our online engagement solutions. For these Pay for Performance (“PFP”) arrangements, we recognize revenue net of the labor provider’s fee in accordance with ASC 605-45, “Principal Agent Considerations,” due primarily to the fact that the call center labor vendor is the primary obligor with respect to the labor services provided. Additionally, we perform as an agent without risk of loss for collection and do not bear inventory risk with respect to the outsourced labor services. Finally, we do not provide any part of the labor services, have no latitude in establishing prices for the labor services and generally do not have discretion in selecting the vendor.

The majority of our larger customers 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 customer 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 and determinable. Our service agreements typically have twelve month terms and are terminable or may terminate upon 30 to 90 days’ notice without penalty. When professional service fees add value to the customer on a standalone basis, we recognize professional service fees upon completion and customer acceptance in accordance with FASB Accounting Standards Update 2009-13. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. If a professional services arrangement does not qualify for separate accounting, we recognize the fees, and the related labor costs, ratably over a period of 48 months, representing our current estimate of the term of the customer 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 primarily to the fact that the Expert is the primary obligor. Additionally, we perform as an agent without any risk of loss for collection, and are not involved in selecting the Expert or establishing the Expert’s fee. We collect a fee from the consumer and retain a portion of the fee, and then remit the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable.

***STOCK-BASED COMPENSATION***

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

As of September 30, 2012, there was approximately \$42.2 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of approximately 2.2 years.



## ***ACCOUNTS RECEIVABLE***

Our customers are located primarily in the United States. We perform ongoing credit evaluations of our customers' financial condition (except for customers who purchase the LivePerson services by credit card via Internet download) and have established an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information that we believe to be reasonable, although they may change in the future. If there is a deterioration of a customer's credit worthiness or actual write-offs are higher than our historical experience, our estimates of recoverability for these receivables could be adversely affected. Although our large number of customers limits our concentration of credit risk, we do have several large customers. If we experience a significant write-off from one of these large customers, it could have a material adverse impact on our consolidated financial statements. No single customer accounted for or exceeded 10% of our total revenue in the three and nine months ended September 30, 2012 and 2011. One customer accounted for approximately 16% and 18% of accounts receivable as of September 30, 2012 and December 31, 2011, respectively. During the nine months ended September 30, 2012, we increased our allowance for doubtful accounts by \$20,000 to approximately \$708,000, principally due to an increase in the proportion of our receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate customers that typically have longer payment cycles.

## ***GOODWILL***

In accordance with ASC 350, Goodwill and Other Intangible Assets, goodwill and indefinite-lived intangible assets are not amortized, but reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value below its carrying amount. Goodwill is required to be tested for impairment at least annually. In September 2011, the FASB issued ASU No. 2011-08, Intangibles — Goodwill and Other (Topic 350). ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. If it is determined that the fair value of a reporting unit is more likely than not to be less than its carrying value (including unrecognized intangible assets) than it is necessary to perform the second step of the goodwill impairment test. The second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. We perform internal valuation analyses and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions including projected future cash flows (including timing), discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, determination of appropriate market comparables and the determination of whether a premium or discount should be applied to comparables.

In the third quarter of 2012, we determined that it is not more-likely that the fair value of the reporting units are less than their carrying amount. Accordingly, we did not perform the two-step goodwill impairment test.

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

In accordance with ASC 360-10, "Accounting for the Impairment or Disposal of Long-lived Assets," long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles—Goodwill and Other, General Intangibles Other than Goodwill. 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 customer relationship, accruals and other factors. Actual results could differ from those estimates.

## ***RECENTLY ISSUED ACCOUNTING STANDARDS***

In July 2012, the FASB issued ASU No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles—Goodwill and Other, General Intangibles Other than Goodwill. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. We elected early adoption of this update and it had no impact on our consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. This ASU is intended to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities within the scope of this update. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. An entity is required to apply this amendment for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. ASU No. 2011-11 relates specifically to disclosures, it will not have an impact on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term “fair value.” The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification (Codification) in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. This update did not have an impact 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 customer usage. The majority of our larger customers also pay a professional services fee related to implementation. A large proportion of our revenue from new customers comes from large corporations. These companies typically have more significant implementation requirements and more stringent data security standards. Such customers also have more sophisticated data analysis and performance reporting requirements, and are likely to engage our professional services organization to provide such analysis and reporting on a recurring basis.

Revenue from our Business segment accounted for 91% and 90% of total revenue for the three and nine months ended September 30, 2012, respectively. Revenue attributable to our monthly hosted Business services accounted for 92% and 93% of total Business revenue for the three and nine months ended September 30, 2012, respectively. Revenue from our Business segment accounted for 90% and 89% of total revenue for the three and nine months ended September 30, 2011, respectively. Revenue attributable to our monthly hosted Business services accounted for 95% of total Business revenue for the three and nine months ended September 30, 2011, respectively. Our service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days' notice without penalty. Given the time required to schedule training for our customers' operators and our customers' resource constraints, we have historically experienced a lag between signing a customer contract and recognizing revenue from that customer. 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 9% and 10% of total revenue for the three and nine months ended September 30, 2012, respectively. Revenue generated from online transactions between Experts and Users accounted for approximately 10% and 11% of total revenue for the three and nine months ended September 30, 2011, respectively.

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

## ***OPERATING EXPENSES***

Our cost of revenue consists of:

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

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

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

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

During the nine months ended September 30, 2012, we increased our allowance for doubtful accounts by \$20,000 to \$708,000, principally due to an increase in the proportion of receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate customers that typically have longer payment cycles. During 2011, we increased our allowance for doubtful accounts by \$290,000 to approximately \$851,000, principally due to an increase in accounts receivable as a result of increased sales and, to a lesser extent, to an increase in the proportion of receivables due from customers with greater credit risk. We wrote off approximately \$163,000 of previously reserved accounts, leaving a net allowance for doubtful accounts of approximately \$688,000. A larger proportion of receivables are due from larger corporate customers that typically have longer payment cycles. We base our allowance for doubtful accounts on specifically identified credit risks of customers, historical trends and other information that we believe to be reasonable. We adjust our allowance for doubtful accounts when accounts previously reserved have been collected.

***NON-CASH COMPENSATION EXPENSE***

The net non-cash compensation amounts for the three and nine months ended September 30, 2012 and 2011 consist of:

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2012                                | 2011     | 2012                               | 2011     |
| Stock-based compensation expense related to ASC 718-10 | \$ 2,852                            | \$ 1,736 | \$ 7,646                           | \$ 4,951 |
| Total  | \$ 2,852                            | \$ 1,736 | \$ 7,646                           | \$ 4,951 |

## RESULTS OF OPERATIONS

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

### *Comparison of Three and Nine Months Ended September 30, 2012 and 2011*

**Revenue - Business.** Revenue increased by 17% and 21% to \$36.1 million and \$103.5 million in the three and nine months ended September 30, 2012, respectively, from \$30.8 million and \$85.6 million in the comparable periods in 2011. This increase is primarily attributable to increased revenue from existing customers in the amount of approximately \$2.6 million and \$9.4 million, respectively, net of cancellations and, to a lesser extent, to new customers in the amount of approximately \$1.6 million and \$6.1 million, respectively, and an increase in professional services revenue of approximately \$1.2 million and \$2.7 million, respectively. Our revenue growth has typically been driven by a mix of revenue from new customers as well as expansion of existing customers.

**Revenue - Consumer.** Revenue remained flat at \$3.6 million in the three months ended September 30, 2012 as compared to the comparable period in 2011. Revenue increased by 4% to \$11.4 million in the nine months ended September 30, 2012, from \$11.0 million in the comparable period in 2011. This increase is primarily attributable to an increase in gross revenue as a result of increased chat minutes.

**Cost of Revenue - Business.** Cost of revenue consists of compensation costs relating to employees who provide customer service to our customers, compensation costs relating to our network support staff, the cost of supporting our server and network infrastructure and allocated occupancy costs and related overhead. Cost of revenue increased by 15% and 7% to \$8.5 million and \$23.8 million in the three and nine months ended September 30, 2012, respectively, from \$7.4 million and \$22.3 million in the comparable periods in 2011. The increase is primarily attributable to an increase in compensation and related costs for additional and existing customer service and network operations personnel in the amount of approximately \$860,000 and \$1.4 million, respectively, and an increase for primary and backup server facilities and allocated overhead related costs of supporting our server and network infrastructure of approximately \$275,000 and \$196,000, respectively.

**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 31% and 43% to \$497,000 and 1.6 million in the



three and nine months ended September 30, 2012, respectively from \$921,000 and \$2.8 million in the comparable periods in 2011. This decrease is attributable to the fact that the intangible assets related to the Kasamba acquisition were fully amortized in 2011.

**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 and outsourced labor and expenses for testing new versions of our software. Product development costs increased by 52% and 49% to \$8.0 million and \$21.9 million in the three and nine months ended September 30, 2012, respectively, from \$5.3 million and \$14.7 million in the comparable periods in 2011. This increase is primarily attributable to an increase in compensation and related costs for additional and existing product development personnel of approximately \$2.5 million and \$6.3 million, respectively and to a lesser extent an increase in outsourced labor expense of approximately \$243,000 and \$811,000, respectively as a result of testing new versions of our software. The increase relates to our continued 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 37% to \$11.5 million in the three months ended September 30, 2012, from \$8.4 million in the comparable period in 2011. This increase is primarily attributable to an increase in compensation and related costs for additional and existing sales and marketing personnel of approximately \$3.1 million. Sales and marketing expenses increased by 39% to \$32.6 million in the nine months ended September 30, 2012, from \$23.5 million in the comparable period in 2011. This increase is primarily attributable to an increase in compensation and related costs for additional and existing sales and marketing personnel of approximately \$7.6 million and an increase in advertising and public relations expenses in the amount of approximately \$1.4 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 allocated occupancy costs and related overhead. Sales and marketing expenses decreased by 20% and 9% to \$1.2 million and \$4.2 million in the three and nine months ended September 30, 2012, respectively, from \$1.5 million and \$4.6 million in the comparable periods in 2011. This decrease is primarily attributable to a decrease in compensation and related costs and allocated overhead for marketing personnel in the amount of approximately \$306,000 and \$460,000 respectively.

**General and Administrative.** Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, legal, human resources and administrative personnel. General and administrative expenses increased by 29% to \$7.3 million in the three months ended September 30, 2012 from \$5.7 million in the comparable period in 2011. This increase is primarily attributable to an increase in compensation and related expenses for additional and existing personnel in the amount of approximately \$926,000, and an increase in legal, recruiting and related costs, other professional fees and rent in the amount of approximately \$693,000. General and administrative expenses increased by 52% to \$22.8 million in the nine months ended September 30, 2012 from \$15.0 million in the comparable period in 2011. This increase is primarily attributable to increases in accounting and legal costs related to acquisitions and litigation in the amount of approximately \$2.9 million, increases in other professional fees in the amount of approximately \$1.3 million and increases in costs related to additional and existing personnel in the amount of approximately \$3.3 million.

**Amortization of Intangibles.** Amortization expense was \$11,000 in the three months ended September 30, 2012 and relates to the purchase of patents in August 2009. Amortization expense was \$98,000 in the nine months ended September 30, 2012 and relates primarily to acquisition costs recorded as a result of our acquisition of NuConomy in April 2010 and to the purchase of patents in August 2009. Amortization expense was \$11,000 and \$32,000 in the three and nine months ended September 30, 2011, respectively, and relates to the purchase of patents in August 2009. The increase is attributable to the acquisition costs recorded as a result of our acquisition of NuConomy in April 2010. Additional amortization expense in the amount of \$195,000 and \$921,000 are included in cost of revenue for the nine months ended September 30, 2012 and the comparable period 2011, respectively. Amortization expense is expected to be approximately \$600,000 in the year ended December 31, 2012.

**Other Income (Expense).** Financial income was \$22,000 and \$99,000 in the three and nine months ended September 30, 2012, respectively. Financial expense was \$780,000 and \$418,000 in the three and nine months ended September 30, 2011, respectively. Financial income and expense is the result of currency rate fluctuations associated with the exchange rate movement of the U.S. dollar against the New Israeli Shekel. Interest income was \$19,000 and \$56,000 in the three and nine months ended September 30, 2012, compared to \$18,000 and \$48,000 in the comparable periods in 2011, respectively, and consists of interest earned on cash and cash equivalents.

**Provision for Income Taxes.** Our effective tax rate was 39.2% and 39.6% for the three and nine months ended September 30, 2012, respectively, resulting in a provision for income taxes of \$1.0 million and \$3.2 million in the three and nine months ended September 30, 2012, respectively. Our effective tax rate was 37% and 38% for the three and nine months ended September 30, 2011, respectively, resulting in a provision for income taxes of \$1.6 million and \$5.0 million in the comparable periods in 2011, respectively.

**Net Income.** We had net income of \$1.6 million in the three months ended September 30, 2012, as compared to net income of \$2.7 million in the comparable period in 2011. Revenue increased by \$5.3 million, while operating expenses increased by \$7.8 million, other expense decreased \$803,000, and provision for income taxes decreased \$579,000, contributing to a net decrease in net income of approximately \$1.1 million. We had net income of \$4.9 million in the nine months ended September 30, 2012, as compared to net income of \$8.2 million in the comparable period in 2011. Revenue increased by \$18.3 million, while operating expenses increased by \$24.0 million, other expense decreased \$524,000, and provision for income taxes decreased \$1.8 million, contributing to a net decrease in net income of approximately \$3.3 million.

## LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2012, we had approximately \$103.3 million in cash and cash equivalents, an increase of approximately \$10.0 million from December 31, 2011. 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 acquisitions of Look.io and Amadesa and the purchases of fixed assets related to the build-out of our co-location facility. We invest our cash in short-term money market funds.

Net cash provided by operating activities was \$17.7 million for the nine months ended September 30, 2012 and consisted primarily of net income, non-cash expenses related to ASC 718-10, amortization of intangibles and depreciation, and to increases in accounts payable, accrued expenses and deferred revenue, partially offset by an increase in accounts receivable and prepaid expenses. Net cash provided by operating activities was \$17.4 million for the nine months ended September 30, 2011 and consisted primarily of net income, non-cash expenses related to ASC 718-10, amortization of intangibles and depreciation, and to decreases in prepaid expenses and other current assets and an increase in deferred revenue, partially offset by an increase in accounts receivable and a decrease in accrued expenses.

Net cash used in investing activities was \$18.7 million in the nine months ended September 30, 2012, and was due primarily to our purchase of technology assets from Amadesa, our acquisition of Look.io, and the purchase of fixed assets for our co-location facilities. Net cash used in investing activities was \$6.2 million in the nine months ended September 30, 2011, and was due primarily to the build-out of new office space in New York and Israel, and to a lesser extent, to purchases of fixed assets for our co-location facilities.

Net cash provided by financing activities was \$11.2 million for the nine months ended September 30, 2012 and consisted primarily of the proceeds from the issuance of common stock in connection with the exercise of stock options by employees, and, to a lesser extent the excess tax benefit from the exercise of employee stock options. Net cash provided by financing activities was \$8.3 million for the nine months ended September 30, 2011 and consisted primarily of the proceeds from the issuance of common stock in connection with the exercise of stock options by

employees and, to a lesser extent the excess tax benefit from the exercise of employee stock options.

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 September 30, 2012, we had an accumulated deficit of approximately \$83.3 million. These losses have been funded primarily through the issuance of common stock in our initial public offering and, prior to the initial public offering, the issuance of convertible preferred stock.

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

## **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

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

We lease facilities and certain equipment under agreements accounted for as operating leases. These leases generally require us to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the three and nine months ended September 30, 2012 was approximately \$2.0 million and \$5.3 million, respectively, and approximately \$1.6 million and \$5.1 million for the three and nine months ended September 30, 2011, respectively.

As of September 30, 2012, our principal commitments were approximately \$21.0 million under various operating leases, of which approximately \$2.2 million is due in 2012. We currently expect that our principal commitments for the year ending December 31, 2012 will not exceed \$8.0 million in the aggregate.

Our contractual obligations at September 30, 2012 are summarized as follows:

|                         | <b>Payments due by period</b> |                  |           |           |                   |
|-------------------------|-------------------------------|------------------|-----------|-----------|-------------------|
|                         | (in thousands)                |                  |           |           |                   |
| Contractual Obligations | Total                         | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Operating leases        | \$21,012                      | \$ 2,235         | \$ 12,927 | \$ 4,115  | \$ 1,735          |
| Total                   | \$21,012                      | \$ 2,235         | \$ 12,927 | \$ 4,115  | \$ 1,735          |

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

#### *Currency Rate Fluctuations*

As a result of the expanding scope of our Israeli operations, our currency rate fluctuation risk associated with the exchange rate movement of the U.S. dollar against the New Israeli Shekel (“NIS”) has increased. During the three months ended September 30, 2012, the U.S dollar depreciated approximately .3% as compared to the NIS. During the nine months ended September 30, 2012, the U.S dollar appreciated approximately 2% as compared to the NIS. During the nine month period ended September 30, 2012, expenses generated by our Israeli operations totaled approximately \$30.1 million. We do not currently hedge our foreign currency risk exposure. We actively monitor the movement of the U.S. dollar against the NIS and U.K. pound and have considered the use of financial instruments, including but not limited to derivative financial instruments, which could mitigate such risk. If we determine that our risk of exposure materially exceeds the potential cost of derivative financial instruments, we may in the future enter in to these types of investments. The functional currency of our wholly-owned Israeli subsidiaries, LivePerson Ltd. (formerly HumanClick Ltd.) and Kasamba Ltd., is the U.S. dollar and the functional currency of our operations in the United Kingdom is the U.K. pound.

#### *Collection Risk*

Our accounts receivable are subject, in the normal course of business, to collection risks. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of collection risks. During the nine months ended September 30, 2012, we increased our allowance for doubtful accounts \$20,000 to

\$708,000, principally due to an increase in the proportion of our receivables due from customers with greater credit risk. A larger proportion of receivables are due from larger corporate customers that typically have longer payment cycles. During the nine months ended September 30, 2011, we increased our allowance for doubtful accounts \$230,000 to \$791,000, principally due to an increase in accounts receivable as a result of increased sales and, to a lesser extent, to an increase in the proportion of our receivables due from customers with greater credit risk. We wrote off approximately \$163,000 of previously reserved accounts, leaving a net allowance for doubtful accounts of approximately \$628,000. A larger proportion of receivables are due from larger corporate customers that typically have longer payment cycles.

*Interest Rate Risk*

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

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### *Evaluation of Disclosure Controls and Procedures*

Our management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our “disclosure controls and procedures,” as that term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of September 30, 2012. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2012 to ensure that the information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms, and to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

##### *Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2012 identified in connection with the evaluation thereof by our management, including the Chief Executive Officer and Chief Financial Officer, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

##### *Limitations of the Effectiveness of Internal Control*

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



## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

On June 15, 2011, we filed suit against Lodsys, LLC, in the United States District Court for the Northern District of Illinois, seeking a declaratory judgment that our products do not infringe four patents which Lodsys had previously asserted were infringed by our customers, as well as a declaratory judgment that those four patents are invalid; that case was transferred to the Eastern District of Wisconsin on October 25, 2011, based on a joint motion filed by the parties. On July 5, 2011, Lodsys countersued us and other plaintiffs in similarly-situated declaratory judgment actions, including DriveTime Automotive Group, Inc., ESET, LLC, ForeSee Results, LLC, OpinionLab, Inc., and The New York Times Company, in the United States District Court for the Eastern District of Texas. In the Texas case, Lodsys alleged that we infringed two of the patents involved in the co-pending declaratory judgment case, and sought damages for past infringement, and an injunction against future infringement. In July 2012, the parties reached a mutual, confidential agreement resolving all claims and counterclaims against each party. The terms of the agreement did not have a material impact on our ongoing operations. All pending claims asserted in both litigations were dismissed with prejudice by the parties in August 2012, ending our involvement in those cases.

On February 7, 2012, we filed suit against Pragmatum Telecom LLC in the District of Delaware, seeking a declaratory judgment that our products do not infringe three patents owned by Pragmatum which Pragmatum had previously asserted were infringed by certain of our customers. On March 13, 2012, we amended our complaint to add a request for a declaratory judgment that those three patents are invalid. On April 6, 2012, Pragmatum answered the Amended Complaint, and asserted counterclaims against us asserting infringement of the same three patents. Pursuant to a June 1, 2012 Scheduling Order entered by the Court, trial in this matter will begin on or after September 8, 2014. Although we currently do not expect that the outcome of this matter will have a material adverse effect on our financial condition or results of operations, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered, that could adversely affect our operating results or cash flows in a particular period.

On September 14, 2012, Community United IP, LLC filed a patent infringement case against us, along with co-defendants 1-800-Flowers.com, Discover Card Services, Inc., EarthLink, Inc., QVC, Inc., and Cellco Partnership d/b/a Verizon Wireless based on the co-defendants' alleged use of technology supplied by us, in the District of Delaware. Defendants' answers or other pleadings responding to the complaint are currently due on November 8, 2012. We currently do not expect that the outcome of this matter will have a material adverse effect on our financial condition or results of operations, however, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered that could adversely affect our operating results or cash flows in a particular period.

We routinely assess all of our litigation and threatened litigation as to the probability of ultimately incurring a liability, and record our best estimate of the ultimate loss in situations where we assess the likelihood of loss as probable.

From time to time, we are involved in other legal proceedings arising in the ordinary course of its business, which may arise from, among other things, direct legal claims brought by or against us, or from claims brought against our customers for which we have a contractual indemnification obligation.

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

Risks that could have a material and adverse impact on our business, results of operations and financial condition include the following: potential fluctuations in our quarterly and annual results; potential fluctuations in litigation, transaction-related and other costs; costs associated with our international expansion; the adverse effect that the economic downturn may have on our business and results of operations; competition in the real-time sales, marketing, customer service and online engagement solutions market; our ability to retain existing customers and attract new customers; risks related to new regulatory or other legal requirements that could materially impact our business; impairments to goodwill that result in significant charges to earnings; volatility of the value of certain currencies in relation to the U.S. dollar, particularly the New Israeli Shekel, U.K. pound and Euro; risks related to our international operations, particularly our operations in Israel, and the civil and political unrest in that region; responding to rapid technological change and changing customer preferences; our ability to retain key personnel and attract new personnel; risks related to the ability to successfully integrate past or potential future acquisitions; technology systems beyond our control and technology-related defects that could disrupt the LivePerson services; privacy concerns relating to the Internet that could result in new legislation or negative public perception; risks related to the regulation or possible misappropriation of personal information belonging to our customers' Internet users; legal liability and/or negative publicity for the services provided to consumers via our technology platforms; risks related to protecting our intellectual property rights or potential infringement of the intellectual property rights of third parties; and risks related to our common stock being traded on more than one securities exchange, which may result in additional variations in the trading price of our common stock. This list is intended to identify only certain of the principal factors that could have a material and adverse impact on our business, results of operations and financial condition. A more detailed description of each of these and other important risk factors can be found under the caption "Risk Factors" in our most recent Annual Report on Form 10-K filed on March 13, 2012.

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

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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

**ITEM 5. OTHER INFORMATION**

None.

32

## ITEM 6. EXHIBITS

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

- 31.1 Certification by Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification by Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1\* Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2\* Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
  
- 101.INS\*\* XBRL Instance Document
- 101.SCH\*\* XBRL Taxonomy Extension Schema Document
- 101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF\*\* XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB\*\* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document

\* These certifications are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference in any filing we make under the Securities Act of 1933 or the Securities Exchange Act of 1934, irrespective of any general incorporation language in any filings.

\*\* In accordance with Rule 406T of Regulation S-T, these XBRL (eXtensible Business Reporting Language) documents are furnished and not filed as a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.



**SIGNATURES**

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

**LIVEPERSON, INC.**  
(Registrant)

Date: November 9, 2012 By: /s/ ROBERT P. LOCASCIO  
Name: Robert P. LoCascio  
Title: Chief Executive Officer (principal executive officer)

Date: November 9, 2012 By: /s/ DANIEL R. MURPHY  
Name: Daniel R. Murphy  
Title: Chief Financial Officer (principal  
financial and accounting officer)

EXHIBIT INDEX

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