

LIVEPERSON INC
Form 10-Q
November 09, 2016

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

FORM 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from _____ to _____

Commission file number: 000-30141

LIVEPERSON, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware 13-3861628

(State or Other Jurisdiction of
Incorporation or Organization) (IRS Employer Identification No.)

475 Tenth Avenue, 5th Floor
New York, New York 10018

(Address of Principal Executive Offices) (Zip Code)

(212) 609-4200

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ 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 ☒

On November 7, 2016, 57,970,850 shares of the registrant's common stock were outstanding.

LIVEPERSON, INC.
September 30, 2016
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FORWARD-LOOKING STATEMENTS

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

Part I. Financial Information

Item 1. Financial Statements

LIVEPERSON, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

(UNAUDITED)

| | September 30, 2016 | December 31, 2015 (Note 1) |
|-------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 51,405 | \$ 48,803 |
| Cash held as collateral | 3,966 | 5,409 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,742 and \$1,184 as of September 30, 2016 and December 31, 2015, respectively | 29,488 | 30,388 |
| Prepaid expenses and other current assets | 10,847 | 9,327 |
| Deferred tax assets, net | — | 455 |
| Total current assets | 95,706 | 94,382 |
| Property and equipment, net | 24,111 | 24,129 |
| Intangibles, net | 20,012 | 24,619 |
| Goodwill | 80,381 | 80,322 |
| Deferred tax assets, net | 1,076 | 785 |
| Other assets | 2,425 | 1,957 |
| Total assets | \$ 223,711 | \$ 226,194 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 5,768 | \$ 7,102 |
| Accrued expenses and other current liabilities | 32,601 | 34,296 |
| Deferred revenue | 26,454 | 13,862 |
| Total current liabilities | 64,823 | 55,260 |
| Other liabilities | 3,254 | 3,270 |
| Deferred tax liability | 4,236 | 2,359 |
| Total liabilities | 72,313 | 60,889 |
| Commitments and contingencies | | |
| STOCKHOLDERS' EQUITY: | | |
| Common stock | 58 | 57 |
| Additional paid-in capital | 289,907 | 286,856 |
| Treasury stock | (2 |) (1 |
| Accumulated deficit | (135,379 |) (119,071 |
| Accumulated other comprehensive loss | (3,186 |) (2,536 |
| Total stockholders' equity | 151,398 | 165,305 |
| Total liabilities and stockholders' equity | \$ 223,711 | \$ 226,194 |

See Notes to Condensed Consolidated Financial Statements (unaudited).

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | | |
|----------------------------------------------------------------------|-------------------------------------|------------|------------------------------------|------------|----------------|
| | 2016 | 2015 | 2016 | 2015 | |
| Revenue | \$ 54,518 | \$ 60,757 | \$ 166,662 | \$ 179,861 | |
| Costs and expenses ^{(1) (2)} | | | | | |
| Cost of revenue ⁽³⁾ | 14,837 | 18,225 | ⁽⁴⁾ 48,210 | 52,531 | ⁽⁴⁾ |
| Sales and marketing | 22,067 | 23,286 | 67,831 | 71,962 | |
| General and administrative | 10,069 | 6,587 | ⁽⁴⁾ 29,758 | 27,058 | ⁽⁴⁾ |
| Product development | 9,495 | 9,567 | 29,428 | 29,476 | |
| Restructuring costs | (384) | — | (384) | 2,988 | |
| Amortization of purchased intangibles | 1,013 | 1,193 | 2,954 | 3,683 | |
| Total costs and expenses | 57,097 | 58,858 | 177,797 | 187,698 | |
| (Loss) income from operations | (2,579) | 1,899 | (11,135) | (7,837) | |
| Other expense | (123) | (369) | (135) | (371) | |
| (Loss) income before provision for (benefit from) income taxes | (2,702) | 1,530 | (11,270) | (8,208) | |
| Provision for (benefit from) income taxes | 3,177 | (395) | 5,038 | (2,721) | |
| Net (loss) income | \$(5,879) | \$ 1,925 | \$(16,308) | \$(5,487) | |
| Net (loss) income per share of common stock: | | | | | |
| Basic | \$(0.10) | \$ 0.03 | \$(0.29) | \$(0.10) | |
| Diluted | \$(0.10) | \$ 0.03 | \$(0.29) | \$(0.10) | |
| Weighted-average shares used to compute net (loss) income per share: | | | | | |
| Basic | 56,047,645 | 56,525,647 | 56,131,818 | 56,437,198 | |
| Diluted | 56,047,645 | 57,084,437 | 56,131,818 | 56,437,198 | |

⁽¹⁾ Amounts include stock-based compensation expense, as follows:

| | | | | |
|----------------------------|--------|--------|--------|----------|
| Cost of revenue | \$ 121 | \$ 288 | \$ 342 | \$ 1,092 |
| Sales and marketing | 502 | 760 | 1,936 | 2,292 |
| General and administrative | 759 | 911 | 2,552 | 2,590 |
| Product development | 873 | 927 | 2,770 | 2,819 |

⁽²⁾ Amounts include depreciation expense, as follows:

| | | | | |
|----------------------------|----------|----------|----------|----------|
| Cost of revenue | \$ 1,756 | \$ 2,266 | \$ 6,469 | \$ 6,491 |
| Sales and marketing | 212 | 254 | 1,012 | 819 |
| General and administrative | 435 | 190 | 1,215 | 663 |
| Product development | 247 | 229 | 749 | 626 |

⁽³⁾ Amounts include amortization of purchased intangibles, as follows:

| | | | | |
|-----------------|--------|--------|----------|----------|
| Cost of revenue | \$ 697 | \$ 760 | \$ 2,091 | \$ 2,439 |
|-----------------|--------|--------|----------|----------|

⁽⁴⁾ The Company reclassified \$1.3 million and \$1.5 million in the three and nine months ended September 30, 2016, respectively, related to the fair value adjustment of the contingent earn-out for CAO! and Engage from cost of revenue to general and administrative expenses to conform to the full year presentation.

See Notes to Condensed Consolidated Financial Statements (unaudited).

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

| | Three Months Ended | | Nine Months Ended | |
|-----------------------------------------|--------------------|-----------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net (loss) income | \$ (5,879) | \$ 1,925 | \$ (16,308) | \$ (5,487) |
| Foreign currency translation adjustment | 1,848 | (2,374) | (650) | (1,303) |
| Comprehensive loss | \$ (4,031) | \$ (449) | \$ (16,958) | \$ (6,790) |

See Notes to Condensed Consolidated Financial Statements (unaudited).

LIVEPERSON, INC.

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

| | Nine Months Ended September 30, | |
|-----------------------------------------------------------------------------------|------------------------------------|----------------|
| | 2016 | 2015 |
| OPERATING ACTIVITIES: | | |
| Net loss | \$(16,308) | \$(5,487) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Stock-based compensation expense | 7,600 | 8,793 |
| Depreciation | 9,445 | 8,599 |
| Amortization of purchased intangibles | 5,045 | 6,122 |
| Deferred income taxes and other non-cash tax items | 163 | (4,103) |
| Change in fair value contingent consideration | — | 3,792 |
| Provision for doubtful accounts, net | 1,240 | 1,688 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (340) | (2,750) |
| Prepaid expenses and other current assets | (1,627) | (1,278) |
| Other assets | (32) | 85 |
| Accounts payable | (1,404) | (2,494) |
| Accrued expenses and other current liabilities | (1,690) | (2,705) |
| Deferred revenue | 12,593 | (1,697) |
| Other liabilities | 1,865 | 2,300 |
| Net cash provided by operating activities | 16,550 | 10,865 |
| INVESTING ACTIVITIES: | | |
| Purchases of property and equipment, including capitalized software | (9,251) | (11,047) |
| Cash held as collateral for foreign exchange forward contracts | 1,443 | (5,400) |
| Payments for acquisitions and intangible assets, net of cash acquired | (411) | (150) |
| Net cash used in investing activities | (8,219) | (16,597) |
| FINANCING ACTIVITIES: | | |
| Excess tax benefit from the exercise of employee stock options | — | 796 |
| Proceeds from issuance of common stock in connection with the exercise of options | 838 | 3,758 |
| Payments related to contingent consideration | — | (2,366) |
| Repurchase of common stock | (5,773) | (4,202) |
| Net cash used in financing activities | (4,935) | (2,014) |
| EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS | (794) | (782) |
| CHANGE IN CASH AND CASH EQUIVALENTS | 2,602 | (8,528) |
| CASH AND CASH EQUIVALENTS - Beginning of the period | 48,803 | 49,372 |
| CASH AND CASH EQUIVALENTS - End of the period | \$51,405 | \$40,844 |
| SUPPLEMENTAL DISCLOSURE OF OTHER CASH FLOW INFORMATION: | | |
| Cash paid for income taxes | \$628 | \$1,497 |

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING
ACTIVITIES:

| | | |
|-----------------------------------------------------------------|-------|-------|
| Purchase of property and equipment recorded in accounts payable | \$53 | \$277 |
| Leasehold improvements funded by landlord | \$107 | \$— |

See Notes to Condensed Consolidated Financial Statements (unaudited).

LIVEPERSON, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Description of Business and Basis of Presentation

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

LivePerson provides mobile and online messaging technologies that power digital communication between brands and consumers. LiveEngage, the Company’s enterprise-class, cloud-based platform, enables businesses to create a meaningful connection with consumers by offering messaging as a preferred channel of communication. Messaging diminishes the need to rely on email systems or call a 1-800 number. Brands leverage LivePerson’s sophisticated intelligence engine and suite of text and mobile messaging, real-time chat messaging, content delivery, and co-browsing offerings to proactively engage with consumers through m-dot sites, mobile apps, the desktop, social media and third-party consumer messaging platforms. The Company’s campaign-based messaging enables the brand to target the right consumer at the right time on a brand’s site by leveraging proprietary analysis and data-driven intelligence.

The data that the Company gathers and analyzes, on behalf of its customers, spans the breadth of an online or mobile visitor session, starting from an initial keyword search or application login, through actions on the website or mobile application of the Company’s customer, and even into a shopping cart and an executed sale. The Company combines this session data with other historical, behavioral and operational information to develop insights into each step of a consumer’s journey for sales and service transactions. These unique, industry- and use-case specific insights are mapped to each brand’s business goals in order to deliver successful campaign outcomes. LivePerson’s products, coupled with its domain knowledge, industry expertise and consulting services, have been proven to maximize the effectiveness of consumer engagement.

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 mobile and online messaging with individual consumers (“Users”).

Basis of Presentation

The accompanying condensed consolidated financial statements as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 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, 2016, and the consolidated results of operations, comprehensive loss and cash flows for the interim periods ended September 30, 2016 and 2015. 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, 2015 has been derived from audited consolidated financial statements at that date.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto for the year ended December 31, 2015, included in the Company’s Annual Report on Form 10-K filed with the SEC on March 15, 2016.

Principles of Consolidation

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

Reclassification

For comparability, certain 2015 amounts have been reclassified, where appropriate, to conform to the financial presentation in 2016. The Company reclassified \$1.3 million and \$1.5 million in the three and nine ended September 30, 2016, respectively, related to the fair value adjustment of the contingent earn-out for CAO! and Engage Pty Ltd. ("Engage") from cost of revenue to general and administrative expenses.

Use of Estimates

The preparation of the Company's condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of income and expenses during the reporting period. These estimates are based on information available as of the date of the condensed consolidated financial statements; therefore, actual results could differ from management's estimates.

Recently Issued Accounting Standards

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). Topic 230 addresses the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The Company is in the process of evaluating the impact of adoption of ASU 2016-15 on its financial statements.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, "Compensation -Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). This update is intended to improve the accounting for employee share-based payments and affects all organizations that issue share-based payment awards to their employees. Several aspects of the accounting for share-based payment award transactions are simplified, including:(a) income tax consequences; (b) classification of awards as either equity or liabilities; and(c)classification on the statement of cash flows. ASU 2016-09 is effective for financial statements issued for annual periods beginning after December 15, 2016. The Company is currently in the process of evaluating the impact of adoption of ASU 2016-09 on its financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, "Leases" ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new lease guidance also simplified the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees will no longer be provided with a source of off-balance sheet financing. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. ASU 2016-02 is effective for financial statements issued for annual periods beginning after December 15, 2018. The Company is currently in the process of evaluating the impact of adoption of ASU 2016-02 on its financial statements.

In November 2015, FASB issued Accounting Standards Update No. 2015-17, "Income taxes: Balance Sheet Classification of Deferred Taxes Business" ("ASU 2015-17"). Topic 740, Income Taxes, requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the

related asset or liability for financial reporting. Deferred tax liabilities and assets that are not related to an asset or liability for financial reporting are classified according to the expected reversal date of the temporary difference. To simplify the presentation of deferred income taxes, ASU 2015-17 requires that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company has elected to early adopt ASU 2015-17 on its financial statements during the second quarter of 2016 on a prospective basis.

In September 2015, FASB issued Accounting Standards Update No. 2015-16, “Business Combinations: Simplifying the Accounting for Measurement-Period Adjustments” (“ASU 2015-16”). ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in ASU 2015-16 require that the acquirer record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 is effective for annual reporting periods beginning after December 15, 2015. This standard became effective for the Company in the first quarter of 2016, and is applied on a prospective basis to adjustments to provisional amounts that occur after the effective date with no material impact to its financial statements.

In February 2015, FASB issued Accounting Standards Update No. 2015-02, Consolidation: Amendments to the Consolidation Analysis (“ASU 2015-02”), which affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The standard amends the consolidation requirements in ASC 810. ASU 2015-02 is effective for fiscal periods beginning after December 15, 2015 for public companies, and early adoption is permitted. The Company adopted this standard during the first quarter of 2016 and there was no material impact to its financial statements.

In May 2014, FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which supersedes most existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). In March 2016, the FASB issued implementation guidance that clarified the considerations in principal versus agent determination. In April 2016, the FASB issued guidance that clarified identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. In May 2016, FASB issued guidance that addresses narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. The Company will adopt this guidance at the beginning of its first quarter of fiscal year 2018. Adoption of this guidance is not expected to have a material impact on the Company’s financial statements.

2. Revenue Recognition

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

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

The Company also sells certain of the LivePerson services directly via Internet download. These services are marketed as LiveEngage for small to medium-sized businesses, and are paid for almost exclusively by credit card. Credit card payments accelerate cash flow and reduce the Company’s collection risk, subject to the merchant bank’s right to hold back cash pending settlement of the transactions. Sales of LiveEngage may occur with or without the

assistance of an online sales representative, rather than through face-to-face or telephone contact that is typically required for traditional direct sales.

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

which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) best estimated selling price. If a professional services arrangement does not qualify for separate accounting, the Company recognizes the fees, and the related labor costs, ratably over the contracted period.

For revenue from the Company's Consumer segment generated from online transactions between Experts and Users, the Company recognizes revenue net of the Expert fees in accordance with ASC 605-45, "Principal Agent Considerations," due primarily to the fact that the Expert is the primary obligor. Additionally, the Company performs as an agent without any risk of loss for collection, and is not involved in selecting the Expert or establishing the Expert's fee. The Company collects a fee from the User and retains a portion of the fee, and then remits the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant Company obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed and determinable.

3. Net Income (Loss) Per Share

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

Diluted net loss per common share for the three and nine months ended September 30, 2016 does not include the effect of 9,492,949 outstanding common stock awards, as the effect of their inclusion is anti-dilutive. Diluted net loss per common share for the three months ended September 30, 2015 includes the effect of options to purchase 1,429,142 shares of outstanding common stock with a weighted average exercise price of \$9.02. Diluted net loss per common share for the three months ended September 30, 2015 does not include the effect of 8,140,127 outstanding common stock awards, as the effect of their inclusion is anti-dilutive. Diluted net loss per common share for the nine months ended September 30, 2015 does not include the effect of 9,569,269 outstanding common stock awards, as the effect of their inclusion is anti-dilutive.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|------------|------------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Basic | 56,047,645 | 56,525,647 | 56,131,818 | 56,437,198 |
| Effect of assumed exercised options | — | 558,790 | — | — |
| Diluted | 56,047,645 | 57,084,437 | 56,131,818 | 56,437,198 |

4. Segment Information

The Company accounts for its segment information in accordance with the provisions of ASC 280-10, "Segment Reporting." ASC 280-10 establishes annual and interim reporting standards for operating segments of a company. ASC 280-10 requires disclosures of selected segment-related financial information about products, major customers, and geographic areas based on the Company's internal accounting methods. The Company is organized into two operating segments for purposes of making operating decisions and assessing performance. The Business segment facilitates real-time online interactions – chat, voice and content delivery across multiple channels and screens for global corporations of all sizes. The Consumer segment facilitates online transactions between Experts and Users and sells its services to consumers. Both segments currently generate their revenue primarily in the United States. The chief operating decision maker, who is the chief executive officer, evaluates performance, makes operating decisions, and allocates resources based on the operating income of each segment. The reporting segments follow the same accounting policies used in the preparation of the Company's condensed consolidated financial statements which are described in the summary of significant accounting policies. The Company allocates cost of revenue, sales and marketing and amortization of purchased intangibles to the segments, but it does not allocate product development

expenses, general and administrative expenses, restructuring costs 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, 2016, based on the Company's internal financial reporting system utilized by the Company's chief operating decision maker, follows (amounts in thousands):

| | Business | Consumer | Corporate | Consolidated |
|---------------------------------------|-----------|----------|------------|--------------|
| Revenue: | | | | |
| Hosted services – Business | \$ 44,553 | \$ — | \$— | \$ 44,553 |
| Hosted services – Consumer | — | 4,044 | — | 4,044 |
| Professional services | 5,921 | — | — | 5,921 |
| Total revenue | 50,474 | 4,044 | — | 54,518 |
| Cost of revenue | 14,215 | 622 | — | 14,837 |
| Sales and marketing | 20,278 | 1,789 | — | 22,067 |
| Amortization of purchased intangibles | 1,013 | — | — | 1,013 |
| Unallocated corporate expenses | — | — | 19,180 | 19,180 |
| Operating income (loss) | \$ 14,968 | \$ 1,633 | \$(19,180) | \$ (2,579) |

Summarized financial information by segment for the three months ended September 30, 2015, based on the Company's internal financial reporting system utilized by the Company's chief operating decision maker, follows (amounts in thousands):

| | Business | Consumer | Corporate | Consolidated |
|---------------------------------------|-----------|----------|------------|--------------|
| Revenue: | | | | |
| Hosted services – Business | \$ 50,957 | \$ — | \$— | \$ 50,957 |
| Hosted services – Consumer | — | 3,661 | — | 3,661 |
| Professional services | 6,139 | — | — | 6,139 |
| Total revenue | 57,096 | 3,661 | — | 60,757 |
| Cost of revenue | 17,652 | 573 | — | 18,225 |
| Sales and marketing | 21,333 | 1,953 | — | 23,286 |
| Amortization of purchased intangibles | 1,193 | — | — | 1,193 |
| Unallocated corporate expenses | — | — | 16,154 | 16,154 |
| Operating income (loss) | \$ 16,918 | \$ 1,135 | \$(16,154) | \$ 1,899 |

Summarized financial information by segment for the nine months ended September 30, 2016, based on the Company's internal financial reporting system utilized by the Company's chief operating decision maker, follows (amounts in thousands):

| | Business | Consumer | Corporate | Consolidated |
|---------------------------------------|------------|----------|------------|--------------|
| Revenue: | | | | |
| Hosted services – Business | \$ 137,240 | \$ — | \$— | \$ 137,240 |
| Hosted services – Consumer | — | 12,048 | — | 12,048 |
| Professional services | 17,374 | — | — | 17,374 |
| Total revenue | 154,614 | 12,048 | — | 166,662 |
| Cost of revenue | 46,145 | 2,065 | — | 48,210 |
| Sales and marketing | 62,606 | 5,225 | — | 67,831 |
| Amortization of purchased intangibles | 2,954 | — | — | 2,954 |
| Unallocated corporate expenses | — | — | 58,802 | 58,802 |
| Operating income (loss) | \$ 42,909 | \$ 4,758 | \$(58,802) | \$ (11,135) |

Summarized financial information by segment for the nine months ended September 30, 2015, based on the Company's internal financial reporting system utilized by the Company's chief operating decision maker, follows (amounts in thousands):

| | Business | Consumer | Corporate | Consolidated |
|---------------------------------------|-----------|----------|------------|--------------|
| Revenue: | | | | |
| Hosted services – Business | \$151,767 | \$ — | \$— | \$ 151,767 |
| Hosted services – Consumer | — | 11,219 | — | 11,219 |
| Professional services | 16,875 | — | — | 16,875 |
| Total revenue | 168,642 | 11,219 | — | 179,861 |
| Cost of revenue | 50,752 | 1,779 | — | 52,531 |
| Sales and marketing | 66,865 | 5,097 | — | 71,962 |
| Amortization of purchased intangibles | 3,683 | — | — | 3,683 |
| Unallocated corporate expenses | — | — | 59,522 | 59,522 |
| Operating income (loss) | \$47,342 | \$ 4,343 | \$(59,522) | \$(7,837) |

Geographic Information

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

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| United States | \$35,114 | \$39,972 | \$111,177 | \$120,409 |
| Other Americas ⁽¹⁾ | 2,073 | 3,589 | 5,165 | 9,437 |
| Total Americas | 37,187 | 43,561 | 116,342 | 129,846 |
| EMEA ^{(2) (4)} | 12,588 | 13,237 | 36,468 | 38,443 |
| APAC ⁽³⁾ | 4,743 | 3,959 | 13,852 | 11,572 |
| Total revenue | \$54,518 | \$60,757 | \$166,662 | \$179,861 |

⁽¹⁾ Canada, Latin America and South America

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

⁽³⁾ Asia-Pacific ("APAC")

⁽⁴⁾ Includes revenues from the United Kingdom of \$8.9 million and \$25.7 million for the three and nine months ended September 30, 2016, respectively. For the three and nine months ended September 30, 2015, revenues from the United Kingdom were \$9.8 million and \$28.1 million, respectively.

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

| | September 30, 2016 | December 31, 2015 |
|-------------------------|--------------------|-------------------|
| United States | \$94,716 | \$96,362 |
| Israel | 14,589 | 16,393 |
| Australia | 9,161 | 8,290 |
| Netherlands | 7,358 | 8,285 |
| Other ⁽¹⁾ | 2,181 | 2,482 |
| Total long-lived assets | \$128,005 | \$131,812 |

⁽¹⁾ United Kingdom, Germany, Japan, France and Italy

No individual customer accounted for 10% or more of consolidated revenue for any of the periods presented. No individual customer accounted for 10% or more of accounts receivable as of September 30, 2016 and December 31, 2015.

5. Goodwill and Intangible Assets

Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2016 are as follows (amounts in thousands):

| | Business | Consumer | Consolidated |
|----------------------------------|-----------|----------|--------------|
| Balance as of December 31, 2015 | \$ 72,298 | \$ 8,024 | \$ 80,322 |
| Adjustments to goodwill: | | | |
| Foreign exchange adjustment | 59 | — | 59 |
| Balance as of September 30, 2016 | \$ 72,357 | \$ 8,024 | \$ 80,381 |

Intangible Assets

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

| | As of September 30, 2016 | | | |
|-------------------------------|--------------------------|--------------------------|---------------------|--------------------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Amortization Period |
| Amortizing intangible assets: | | | | |
| Technology | \$28,059 | \$ (18,777) | \$ 9,282 | 4.7 years |
| Customer relationships | 16,018 | (8,359) | 7,659 | 5.8 years |
| Trade names | 1,298 | (1,275) | 23 | 2.6 years |
| Non-compete agreements | 1,448 | (1,149) | 299 | 1.7 years |
| Patents | 3,851 | (1,129) | 2,722 | 10.4 years |
| Other | 262 | (235) | 27 | 3.0 years |
| Total | \$50,936 | \$ (30,924) | \$ 20,012 | |
| | As of December 31, 2015 | | | |
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Amortization Period |
| Amortizing intangible assets: | | | | |
| Technology | \$28,005 | \$ (15,723) | \$ 12,282 | 4.7 years |
| Customer relationships | 16,008 | (6,873) | 9,135 | 5.8 years |
| Trade names | 1,287 | (1,250) | 37 | 2.6 years |
| Non-compete agreements | 1,446 | (936) | 510 | 1.7 years |
| Patents | 3,440 | (848) | 2,592 | 9.3 years |
| Other | 312 | (249) | 63 | 3.0 years |
| Total | \$50,498 | \$ (25,879) | \$ 24,619 | |

Amortization expense is calculated over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was \$1.7 million and \$2.0 million for the three months ended September 30, 2016 and 2015, respectively. Aggregate amortization expense for intangible assets was \$5.0 million and \$6.1 million for the nine months ended September 30, 2016 and 2015, respectively. For the three and nine months ended September 30, 2016 and 2015, respectively, a portion of this amortization is included in cost of revenue. Estimated amortization expense for the next five years is as follows (amounts in thousands):

| | Estimated Amortization Expense |
|------------|--------------------------------------|
| 2016 | \$ 1,634 |
| 2017 | 4,933 |
| 2018 | 2,834 |
| 2019 | 2,620 |
| 2020 | 2,425 |
| Thereafter | 5,566 |
| Total | \$ 20,012 |

6. Property and Equipment

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

| | September 30, December 31, | |
|------------------------------------------------|----------------------------|-----------|
| | 2016 | 2015 |
| Computer equipment and software | \$ 76,838 | \$ 67,631 |
| Furniture, equipment and building improvements | 13,981 | 13,761 |
| | 90,819 | 81,392 |
| Less: accumulated depreciation | (66,708) | (57,263) |
| Total | \$ 24,111 | \$ 24,129 |

In accordance with its policy, the Company reviews the estimated useful lives of its fixed assets on an ongoing basis. This review indicated that the actual lives of certain co-location assets were longer than the estimated useful lives used for depreciation purposes in the Company's financial statements. As a result, effective August 1, 2016, the Company changed its estimates of the useful lives of its co-location assets to better reflect the estimated periods during which these assets will remain in service. The estimated useful lives of the co-location assets that previously averaged three years were increased to an average of four years. The effect of this change in estimate was to reduce depreciation expense for the three and nine months ended September 30, 2016 by \$0.4 million, decrease net loss by \$0.4 million, and decrease basic and diluted loss per share by \$0.01.

7. Accrued Expenses and Other Current Liabilities

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

| | September 30, December 31, | |
|------------------------------------------------------------|----------------------------|-----------|
| | 2016 | 2015 |
| Payroll and other employee related costs | \$ 14,935 | \$ 14,107 |
| Professional services and consulting and other vendor fees | 11,068 | 12,372 |
| Sales commissions | 2,466 | 4,522 |
| Contingent earnout (see Notes 8 and 9) | 210 | 377 |
| Other | 3,922 | 2,918 |
| Total | \$ 32,601 | \$ 34,296 |

8. Acquisitions

Engage Pty Ltd.

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

The purchase price was approximately \$10.6 million. The total acquisition costs incurred in the year ended December 31, 2012 were approximately \$0.5 million and are included in general and administrative expenses in the Company’s condensed consolidated statements of operations for the same period. The acquisition enhances the Company’s ability to offer intelligent engagement solutions to businesses in the Asia Pacific region. Of the total purchase price, \$0.8 million was allocated to the net book values of the acquired assets and assumed liabilities. The historical carrying amounts of such assets and liabilities approximated their fair values. All receivables acquired are expected to be collectible. The purchase price in excess of the fair value of the net book values of the assets acquired and liabilities assumed was allocated to intangible assets based on management’s best estimate of fair values, taking into account all relevant information available at the time of acquisition, and the excess was allocated to goodwill. The goodwill is not deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. The purchase price includes approximately \$1.7 million of potential earn-out consideration for the shareholders if certain revenue targets are achieved. The earn-out is payable in shares of LivePerson common stock and cash. The Company recorded the contingent earn-out as part of the purchase price. In accordance with ASC 480, the Company had classified this amount as a liability with the amount included in accrued expenses. At June 30, 2015, the Company assessed this earn-out and recorded a \$0.7 million fair value re-measurement adjustment, which was recorded in operating income as a decrease to general and administrative expenses. As of September 30, 2016, there was no remaining liability included in accrued expenses relating to this earn-out.

Synchronite, LLC

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

The allocation of the total purchase price of approximately \$4.1 million was based upon the estimated fair value of Synchronite’s net tangible and identifiable intangible assets as of the date of acquisition. The total acquisition costs incurred were approximately \$0.4 million and are included in general and administrative expenses in the Company’s condensed consolidated statements of operations. Of the total purchase price, \$45,000 was allocated to the net book values of the acquired assets and assumed liabilities. The historical carrying amounts of such assets and liabilities approximated their fair values. All receivables acquired are expected to be collectible. The purchase price includes approximately \$2.7 million of goodwill and approximately \$1.5 million of intangible assets. The goodwill is deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. The purchase price includes \$1.8 million of potential earn-out consideration for the shareholders if complete product integration is achieved. The earn-out is payable in shares of LivePerson common stock and cash. The Company recorded the contingent earn-out as part of the purchase price. In accordance with ASC 480, the Company has classified this amount as a liability and the amount is included in accrued expenses in the September 30, 2016 condensed consolidated balance sheet, due to the variable number of shares that will be issued if and when the targets are achieved. For the year ended December 31, 2015, the Company made \$1.6 million of earn-out payments. The remaining potential earn-out consideration at September 30, 2016 was \$0.2 million. The Company will continue to assess the earn-out calculation in future periods and any future adjustments will affect operating income.

Contact At Once!, LLC

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

in the Company's consolidated results of operations from the date of acquisition.

The allocation of the total purchase price of approximately \$67.0 million, which includes approximately \$42.8 million in cash, approximately \$20.0 million in shares of common stock and approximately \$4.2 million of potential earn-out consideration in cash, was based upon the estimated fair value of CAO!'s net tangible and identifiable intangible assets as of the date of acquisition. The historical carrying amounts of such assets and liabilities approximated their fair values. All receivables acquired are expected to be collectible. The purchase price includes approximately \$45.1 million of goodwill and approximately \$20.4 million of intangible assets. The goodwill will be deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. The purchase price includes \$4.2 million of potential earn-out consideration for the shareholders if certain targeted financial, strategic and integration objectives is achieved. The earn-out is payable in cash. The Company recorded the contingent earn-out as part of the purchase price. In accordance with ASC 480, the Company had classified this amount as a liability included in accrued expenses in the consolidated balance sheet. During the year ended December 31, 2015, the Company assessed this earn-out and recorded a \$3.2 million fair value re-measurement adjustment, which was recorded in loss from operations as a decrease to general and administrative expenses. During the nine months ended September 30, 2016, the Company made cash payments of \$0.2 million. There is no remaining liability included in accrued expenses relating to this contingent earn-out as of September 30, 2016.

9. Fair Value Measurements

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

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs reflect: quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs reflecting the Company's assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

Financial Assets and Liabilities

The carrying amount of cash, accounts receivable, and accounts payable approximate their fair value due to their short-term nature. The Company's assets and liabilities that are measured at fair value on a recurring basis, by level, within the fair value hierarchy as of September 30, 2016 and December 31, 2015, are summarized as follows (amounts in thousands). The Company's restricted cash balance of \$4.0 million at September 30, 2016 and \$5.4 million at December 31, 2015 is not held in a money market account and is not included in the following table.

| | September 30, 2016 | | | | December 31, 2015 | | | |
|---------------------------------------|--------------------|---------|---------|---------|-------------------|---------|---------|---------|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | | | | | |
| Cash equivalents: | | | | | | | | |
| Money market funds | \$3,073 | \$— | \$— | \$3,073 | \$4,059 | \$— | \$— | \$4,059 |
| Foreign currency derivative contracts | — | 965 | — | 965 | — | 102 | — | 102 |
| Total assets | \$3,073 | \$965 | \$— | \$4,038 | \$4,059 | \$102 | \$— | \$4,161 |
| Liabilities: | | | | | | | | |
| Contingent earn-outs | \$— | \$— | \$210 | \$210 | \$— | \$— | \$377 | \$377 |
| Foreign currency derivative contracts | — | 3 | — | 3 | — | 310 | — | 310 |

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Total liabilities \$— \$3 \$210 \$213 \$— \$310 \$377 \$687

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

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fair value. Observable or market inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions based on the best information available.

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

The remaining contingent earn-out amounts as of September 30, 2016 are recorded in accrued expense on the condensed consolidated balance sheet and are payable in 2016. The contingent earn-out balance as of September 30, 2016 relates to Synchronite and is based on the fulfillment of a complete product integration and a minimum number of "Co-Browse" interactions per month.

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

| | Contingent Earn-Out September 30, 2016 | December 31, 2015 |
|------------------------------|----------------------------------------------------|----------------------|
| Balance, Beginning of Period | \$377 | \$ 6,940 |
| Cash payments | (167) | (2,883) |
| Changes in fair value | — | (3,680) |
| Balance, End of Period | \$210 | \$ 377 |

Derivative Financial Instruments

The Company is exposed to foreign exchange risks that in part are managed by using derivative financial instruments. The Company entered into foreign currency forward contracts related to risks associated with foreign operations. The Company does not use derivatives for trading purposes. Derivatives are recorded at their estimated fair values based upon Level 2 inputs. Derivatives designated and effective as cash flow hedges are reported as a component of other comprehensive income and reclassified to earnings in the same periods in which the hedged transactions impact earnings. Gains and losses related to derivatives not meeting the requirements of hedge accounting and the portion of derivatives related to hedge ineffectiveness are recognized in current earnings.

In accordance with the foreign currency forward contracts, the Company was required to pledge cash as collateral security to be maintained at the bank. The collateral shall remain in control of the lender, and these funds can be used to satisfy the outstanding obligation. Accordingly, the Company had cash at the bank of approximately \$4.0 million at September 30, 2016, and \$5.4 million at December 31, 2015 recorded as cash held as collateral in current assets.

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

| | As of September 30, 2016 | As of December 31, 2015 |
|----------------------------------------------------------|--------------------------------|-------------------------------|
| Notional amount of foreign currency derivative contracts | \$ 36,658 | \$ 43,431 |
| Fair value of foreign currency derivatives contracts | \$ 962 | \$ (208) |

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

| | Balance Sheet Location | Fair Value of Derivative Instruments As of September 30, 2016 | As of December 31, 2015 |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|---------------------------------------------------------------------------------|-------------------------------|
| Derivative Assets | | | |
| Derivatives not designated as hedging instruments: | | | |
| Foreign currency derivatives contracts | Prepaid expenses and other current assets | \$ 965 | \$ 102 |
| Derivative Liabilities | | | |
| Derivatives not designated as hedging instruments: | | | |
| Foreign currency derivatives contracts | Accrued expenses and other liabilities | \$ 3 | \$ 310 |
| The following summarizes certain information regarding the Company's derivatives that are not designated or are not effective as hedges (in thousands): | | | |

| | Location | Gain (losses) on Derivative Instruments Recognized in Statements of Operations | | | |
|----------------------------------------|---------------|-----------------------------------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|-----------------------------------------------------|
| | | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
| Foreign currency derivatives contracts | Other expense | \$44 | \$(85) | \$132 | \$(52) |

10. Commitments and Contingencies

Contractual Obligations

The Company leases facilities and certain equipment under agreements accounted for as operating leases. These leases generally require the Company to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the three and nine months ended September 30, 2016 was approximately \$2.4 million and \$7.6 million, respectively. Rental expense for operating leases for the three and nine months ended September 30, 2015 was approximately \$2.4 million and \$5.9 million, respectively.

Employee Benefit Plans

The Company has a 401(k) defined contribution plan covering all eligible employees. The Company provides for employer matching contributions equal to 50% of employee contributions, up to the lesser of 5% of eligible compensation or \$6,000. Matching contributions are deposited into the employee's 401(k) account and are subject to 5 year graded vesting. Salaries and related expenses include \$0.3 million and \$1.0 million of employer matching contributions for the three and nine months ended September 30, 2016, respectively. Salaries and related expenses include \$0.3 million and \$1.0 million of employer matching contributions for the three and nine months ended September 30, 2015, respectively.

Letters of Credit

As of September 30, 2016, the Company has a \$1.9 million letter of credit outstanding substantially in favor of a certain landlord for office space. In addition, the Company has a letter of credit totaling \$0.1 million as a security deposit for the due performance by the Company of the terms and conditions of a supply contract. There were no draws against these letters of credit during the three and nine months ended September 30, 2016.

11. Stockholders' Equity

Common Stock

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As of September 30, 2016, there were 100,000,000 shares of common stock authorized, and 57,919,090 shares issued and outstanding. As of December 31, 2015, there were 100,000,000 shares of common stock authorized, and 57,374,907 shares issued and outstanding. The par value for common shares is \$0.001.

Preferred Stock

As of September 30, 2016 and December 31, 2015, there were 5,000,000 shares of preferred stock authorized, and zero shares issued and outstanding. The par value for preferred shares is \$0.001.

Stock Repurchase Program

On December 10, 2012, the Company's Board of Directors approved a stock repurchase program through June 30, 2014. Under the stock repurchase program, the Company is authorized to repurchase shares of its common stock, in the open market or privately negotiated transactions, at times and prices considered appropriate by the Board of Directors depending upon prevailing market conditions and other corporate considerations. On March 13, 2014, the Company's Board of Directors increased the aggregate purchase price of the stock repurchase program from \$30.0 million to \$40.0 million. On July 23, 2014, the Company's Board of Directors increased the aggregate purchase price of the stock repurchase program from \$40.0 million to \$50.0 million. On March 5, 2015, the Company's Board of Directors extended the expiration date of the program out to December 31, 2016. On February 16, 2016, the Company's Board of Directors increased the aggregate purchase price of the total stock repurchase program by an additional \$14.0 million. There were 1,027,349 shares repurchased under this program during the nine months ended September 30, 2016, which were recorded in treasury stock at par on the condensed consolidated balance sheets as of September 30, 2016. As of September 30, 2016, approximately \$14.3 million remained available for purchase under the program.

Stock-Based Compensation

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

The per share weighted average fair value of stock options granted during the three and nine months ended September 30, 2016 was \$3.11 and \$2.94, respectively. The per share weighted average fair value of stock options granted during the three and nine months ended September 30, 2015 was \$4.10 and \$4.47, 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, | |
| | 2016 | 2015 | 2016 | 2015 |
| Dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |
| Risk-free interest rate | 1.1% | 1.7% | 1.0% - 1.4% | 1.3% - 1.7% |
| Expected life (in years) | 5 | 5 | 5 | 5 |
| Historical volatility | 47.9% | 47.4% | 47.3% - 48.2% | 47.4% - 49.7% |

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

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

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

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

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

Stock Option Plans

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

for issuance 10,000,000 shares of common stock in the aggregate.

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

of shares authorized for issuance under the plan by an additional 4,250,000, thereby reserving for issuance 23,817,744 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have 10-year terms. As of September 30, 2016, approximately 2,014,000 shares of common stock were reserved for issuance under the 2009 Plan (taking into account all option exercises through September 30, 2016).

Employee Stock Purchase Plan

In June 2010, the Company's stockholders approved the 2010 Employee Stock Purchase Plan with 1,000,000 shares of common stock initially reserved for issuance. As of September 30, 2016, approximately 239,000 shares of common stock were reserved for issuance under the Employee Stock Purchase Plan (taking into account all share purchases through September 30, 2016).

Stock Option Activity

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

| | Stock Option Activity | | | Aggregate |
|-------------------------------------------|-----------------------|----------------|----------------------------------------|------------|
| | Options | Weighted | Weighted Average Remaining Contractual | Intrinsic |
| | (in | Average | Term (in years) | Value (in |
| | thousands) | Exercise Price | | thousands) |
| Balance outstanding at December 31, 2015 | 9,139 | \$ 11.05 | | |
| Granted | 473 | 6.92 | | |
| Exercised | (115) | 5.54 | | |
| Cancelled or expired | (1,277) | 11.42 | | |
| Balance outstanding at September 30, 2016 | 8,220 | \$ 10.83 | 6.02 | \$ 4,452 |
| Options vested and expected to vest | 7,761 | \$ 10.92 | 5.86 | \$ 4,169 |
| Options exercisable at September 30, 2016 | 5,898 | \$ 11.11 | 5.19 | \$ 3,724 |

The total fair value of stock options exercised during the nine months ended September 30, 2016 was approximately \$0.4 million. As of September 30, 2016, there was approximately \$8.4 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 2.0 years.

The following table summarizes information about outstanding and vested stock options as of September 30, 2016:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | | |
|--------------------------|---------------------------------------------|--------------------------------------------------------|---------------------------------|---------------------------------|---------------------------------|--|
| | Number of Shares Outstanding (in thousands) | Weighted-Average Remaining Contractual Life (in years) | Weighted-Average Exercise Price | Number of Shares (in thousands) | Weighted-Average Exercise Price | |
| \$1.79 - \$6.32 | 884 | 3.16 | \$ 4.46 | 717 | \$ 4.03 | |
| \$6.54 - \$9.20 | 898 | 6.29 | 7.42 | 529 | 7.44 | |
| \$9.24 - \$9.34 | 842 | 6.30 | 9.26 | 612 | 9.26 | |
| \$9.44 - \$10.09 | 729 | 7.91 | 9.90 | 451 | 9.89 | |
| \$10.13 - \$10.13 | 1,105 | 6.89 | 10.13 | 602 | 10.13 | |
| \$10.31 - \$12.32 | 921 | 6.02 | 11.21 | 676 | 11.47 | |
| \$12.46 - \$13.28 | 1,166 | 5.28 | 13.10 | 1,017 | 13.10 | |
| \$13.34 - \$16.98 | 1,286 | 6.58 | 15.22 | 905 | 15.89 | |
| \$17.88 - \$18.09 | 384 | 5.66 | 18.06 | 384 | 18.06 | |
| \$18.24 - \$18.24 | 5 | 5.83 | 18.24 | 5 | 18.24 | |
| | 8,220 | 6.02 | \$ 10.83 | 5,898 | \$ 11.11 | |

Restricted Stock Unit Activity

A summary of the Company's restricted stock units ("RSUs") activity and weighted average exercise prices follows:

| | Restricted Stock Unit Activity | | |
|--------------------------------------------------|-----------------------------------|-----------|------------|
| | Weighted | | |
| | Number | Average | Aggregate |
| | of | Grant | Fair Value |
| | Shares | Date Fair | (in |
| | (in | Value | thousands) |
| | thousand | Per | |
| | | Share) | |
| Balance outstanding at December 31, 2015 | 1,202 | \$ 10.31 | \$ — |
| Awarded | 571 | 6.32 | — |
| Released | (330) | 10.31 | — |
| Forfeited | (170) | 10.26 | — |
| Non-vested and outstanding at September 30, 2016 | 1,273 | \$ 8.53 | \$ 10,699 |
| Expected to vest | 927 | \$ 8.90 | \$ 7,799 |

RSUs granted to employees generally vest over a four-year period. As of September 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to nonvested RSUs was approximately \$10.3 million and the weighted-average remaining vesting period was 3.0 years.

12. Restructuring

The Company's restructuring costs relate to the termination and severance costs associated with a large customer contract, as well as re-prioritizing and reallocating resources to focus on areas showing high growth potential. There was a benefit of approximately \$0.4 million due to the cash collection of a previously written off bad debt during the three and nine months ended September 30, 2016, which is classified in the condensed consolidated statements of operations as restructuring costs. The expense associated with this restructuring was approximately \$3.0 million during the nine months ended September 30, 2015. The restructuring liability was approximately \$1.5 million as of September 30, 2015 and is classified as accrued expenses and other current liabilities on the condensed consolidated balance sheets. The following table present the detail of expenses and liability for the Company's restructuring charges for the periods presented (amounts in thousands):

| | Expense incurred during the nine months ended September 30, 2015 | Liability as of September 30, 2015 |
|--------------------------------------|---------------------------------------------------------------------------------------|---------------------------------------------|
| Contract termination costs | \$ 1,745 | \$ 569 |
| Severance and other associated costs | 1,243 | 946 |
| Total restructuring costs | \$ 2,988 | \$ 1,515 |

13. Legal Matters

The Company filed an intellectual property suit against [24]7 Customer, Inc. in the Southern District of New York on March 6, 2014 seeking damages on the grounds that [24]7 reverse engineered and misappropriated the Company's technology to develop competing products and misused the Company's business information. Discovery in the New York case is in process. On June 22, 2015, [24]7 Customer, Inc. filed suit against the Company in the Northern District of California alleging patent infringement. On December 7, 2015, [24]7 Customer Inc. filed a second patent infringement suit against the Company, also in the Northern District of California. On January 5, 2016, the two

California cases were consolidated for all pre-trial purposes. The Company believes the claims filed by [24]7 Customer Inc. are without merit and intends to defend them vigorously.

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

From time to time, the Company is involved in or subject to legal, administrative and regulatory proceedings, claims, demands and investigations arising in the ordinary course of business, including direct claims brought by or against the Company with respect to intellectual property, contracts, employment and other matters, as well as claims brought against the Company's customers for whom the Company has a contractual indemnification obligation. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is

required in both the determination of probability and the determination as to whether a loss is reasonably estimable. In addition, in the event the Company determines that a loss is not probable, but is reasonably possible, and it becomes possible to develop what the Company believes to be a reasonable range of possible loss, then the Company will include disclosure related to such matter as appropriate and in compliance with ASC 450. The accruals or estimates, if any, resulting from the foregoing analysis, are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company will, as applicable, adjust the accrual in the period the determination is made, disclose an estimate of the additional loss or range of loss, indicate that the estimate is immaterial with respect to its financial statements as a whole or, if the amount of such adjustment cannot be reasonably estimated, disclose that an estimate cannot be made.

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

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

General

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

Overview

LivePerson was incorporated in the State of Delaware in November 1995 and the LivePerson service was introduced in November 1998. We are a leading provider of mobile and online messaging technologies that power digital communication between brands and consumers. LiveEngage, the Company's enterprise-class, cloud-based platform, enables businesses to create a meaningful connection with consumers by offering messaging as a preferred channel of communication. Messaging diminishes the need to rely on outdated email systems or call a 1-800 number. Brands leverage LiveEngage's sophisticated intelligence engine and suite of text and mobile messaging, real-time chat messaging, content delivery, and cobrowsing offerings to proactively engage with consumers through m-dot sites, mobile apps, the desktop, social media and third-party consumer messaging platforms. Our campaign-based messaging enables the brand to target the right consumer at the right time on a brand's site by leveraging proprietary analysis and data driven intelligence.

We are organized into two operating segments: Business and Consumer. The Business segment enables brands to leverage LiveEngage's sophisticated intelligence engine and suite of online and mobile messaging offerings to proactively engage with consumers. The Consumer segment facilitates online transactions between independent service providers ("Experts") and individual consumers ("Users") seeking information and knowledge for a fee via mobile and online messaging.

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

- Expanding Business with Existing Customers and Adding New Customers. We segmented our sales organization to increase productivity. Our account executives are solely focused on adding new customers, while our account managers are tasked with retaining and expanding existing customers. We also anticipate leveraging our LiveEngage platform to increase adoption of real-time, campaign-based messaging across our customer's online properties and to expand with brands offline, by shifting onto our mobile messaging platform a portion of calls made to 1-800 numbers.

Introducing New Products and Capabilities. We are investing in product marketing, mobile resources, research and development, and executive personnel to support our efforts to build and launch new products and capabilities, to support existing customer deployments, and to further penetrate our total addressable market. These investments are initially focused in the areas of online and mobile consumer engagement, enhanced data and reporting and chat transcript text analysis. Over time, we expect to develop and launch additional capabilities that leverage our existing market position as a leader in mobile and online messaging.

Leveraging Partners to Enhance our Offering. In addition to developing our own applications, we continue to cultivate a partner eco-system capable of offering additional applications and services to our customers. For example, in 2015 we integrated LiveEngage with one of the leading consumer messaging platforms. In addition, we have opened up

access to our platform and our products with application programming interfaces (APIs) that allow third parties to develop on top of our platform. Customers and partners can utilize these APIs to build our capabilities into their own applications and to enhance our applications with their services.

Maintaining Market Leadership in Technology and Security Expertise. As described above, we are devoting significant resources to creating new products and enabling technologies designed to accelerate innovation and delivery of new products and technologies to our customer base. We evaluate emerging technologies and industry standards and continually update our technology in order to retain our leadership position in each market we serve. We monitor legal and technological developments in the area of information security and confidentiality to ensure our policies and procedures meet or exceed

the demands of the world's largest and most demanding corporations. We believe that these efforts will allow us to effectively anticipate changing customer and consumer requirements in our rapidly evolving industry.

Expanding our International Presence. We continue to invest in sales and support personnel in the United Kingdom, Asia-Pacific, Latin America and Western Europe. We are also working with sales and support partners in the Asia-Pacific region. We continue to improve our e-commerce capabilities, and the multi-language and translation capabilities within our hosted solutions to further support international expansion.

Continuing to Build Brand Recognition. As a pioneer of brand-to-consumer digital messaging, LivePerson enjoys strong brand recognition and credibility. Our focus on creating meaningful connections among employees, with our customers, and between brands and their consumers, is a key component of our culture and our market strategy. We strategically target decision makers and influencers within key vertical markets, leveraging customer successes to generate increased awareness and demand for brand-to-consumer messaging.

Increasing the Value of Our Service to Our Customers. We regularly add both new products and services, and new features and functionality to our existing services to further enhance value to our customers. Because we directly manage the server infrastructure, we can make new features available to our customers immediately upon release, without customer or end-user installation of software or hardware. We continue to enhance our reporting, analysis, and administrative tools as part of our overall portfolio of services, as well as our ability to capture, analyze, and report on the substantial amount of online activity data we collect on behalf of our customers to further our customers' online strategies.

Evaluating Strategic Alliances and Acquisitions When Appropriate. We have successfully integrated several acquisitions over the past decade. In addition to our acquisition of Engage referenced above, most recently we acquired Contact At Once!, LLC. ("CAOI"), a unique messaging platform with leading market share in the automotive industry. While we have in the past, and may from time to time in the future, engage in discussions regarding acquisitions or strategic transactions or to acquire other companies that can accelerate our growth or broaden our product offerings, we currently have no binding commitments with respect to any future acquisitions or strategic transactions.

Key Metrics

Financial overview of the three months ended September 30, 2016 compared to the three months ended September 30, 2015:

Total revenue decreased 10% to \$54.5 million from \$60.8 million.

Revenue from our Business segment decreased 12% to \$50.5 million from \$57.1 million.

Gross profit margin increased to 73% from 70%.

Cost and expenses decreased 3% to \$57.1 million from \$58.9 million.

Net loss increased to \$5.9 million from net income of \$1.9 million.

Average annual revenue per enterprise and mid-market customer was greater than \$200,000 over the trailing twelve months ended September 30, 2016, as compared to \$187,000 for the trailing twelve months ended September 30, 2015. The 2015 figure is pro forma to exclude contributions from one large customer contract that ended in 2015.

Customer renewal rate for enterprise and mid-market customers was 83% over the trailing twelve months ended September 30, 2016 compared to 84% over the trailing twelve months ended December 31, 2015.

Adjusted EBITDA and Adjusted Net (Loss) Income

To provide investors with additional information regarding our financial results, we have disclosed adjusted EBITDA and adjusted net income which are non-GAAP financial measures. The tables below present a reconciliation of adjusted EBITDA and adjusted net income to net loss, the most directly comparable GAAP financial measures. We have included adjusted EBITDA and adjusted net income in this Quarterly Report on Form 10-Q because these are key measures used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA and adjusted net income can provide a useful measure for period-to-period comparisons of our core business. Additionally, adjusted EBITDA is a key financial measure used by the compensation committee of our board of directors in connection with the payment

of bonuses to our executive officers. Accordingly, we believe that adjusted EBITDA and adjusted net income provide useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

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

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;

adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

adjusted EBITDA does not consider the potentially dilutive impact of equity-based compensation;

adjusted EBITDA does not consider the potentially dilutive impact of restructuring cost;

adjusted EBITDA does not consider the potentially dilutive impact of other non-recurring costs;

adjusted EBITDA does not reflect tax payments that may represent a reduction in cash available to us; and

other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------------|----------------------------------------|-------------------------|------------------------------------|-------------------------|
| | 2016 | 2015 | 2016 | 2015 |
| Reconciliation of Adjusted EBITDA | | | | |
| GAAP net (loss) income | \$(5,879) | \$1,925 | \$(16,308) | \$(5,487) |
| Amortization of purchased intangibles | 1,710 | 1,953 | 5,045 | 6,122 |
| Stock-based compensation | 2,255 | 2,886 | 7,600 | 8,793 |
| Depreciation | 2,650 | 2,939 | 9,445 | 8,599 |
| Other non-recurring costs | 930 | (1) — | 3,368 | (2) — |
| Contingent earn-out adjustments | — | (3,132) ⁽³⁾ | — | (3,792) ⁽³⁾ |
| Restructuring costs | (384) ⁽⁴⁾ | — | (384) ⁽⁴⁾ | 2,988 ⁽⁵⁾ |
| Provision for (benefit from) income taxes | 3,177 | (395) | 5,038 | (2,721) |
| Other expense | 123 | 369 | 135 | 371 |
| Adjusted EBITDA | \$4,582 | \$6,545 | \$13,939 | \$14,873 |

(1) Includes litigation costs of \$0.9 million for the three months ended.

(2) Includes litigation costs of \$2.9 million and severance costs of \$0.5 million for the nine months ended. For comparability, amounts have been reclassified where appropriate, to conform to current period presentation.

(3) For comparability, amounts have been reclassified where appropriate, to conform to prior period presentation.

(4) Includes \$0.4 million of cash collected on previously written off bad debt.

(5) Includes approximately \$1.7 million of termination costs associated with a large customer contract that ended in 2015 and \$1.2 million of severance and other associated costs.

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

although amortization is a non-cash charge, the assets being amortized may have to be replaced in the future, and

adjusted net (loss) income does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;

adjusted net (loss) income does not consider the potentially dilutive impact of equity-based compensation;

adjusted net (loss) income does not consider the potentially dilutive impact of restructuring cost;

adjusted net (loss) income does not consider the potentially dilutive impact of other non recurring costs;

adjusted net (loss) income does not consider the potentially dilutive impact of deferred tax asset valuation allowance;
and
other companies, including companies in our industry, may calculate adjusted net income differently, which reduces its usefulness as a comparative measure.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------------------------|----------------------------------------|--------------|------------------------------------|---------------|
| | 2016 | 2015 | 2016 | 2015 |
| Reconciliation of Adjusted Net (Loss) Income | | | | |
| GAAP net (loss) income | \$(5,879) | \$1,925 | \$(16,308) | \$(5,487) |
| Amortization of purchased intangibles | 1,710 | 1,953 | 5,045 | 6,122 |
| Stock-based compensation | 2,255 | 2,886 | 7,600 | 8,793 |
| Other non-recurring costs | 930 | (1) — | 3,718 | (2) — |
| Contingent earn-out adjustments | — | (3,132) | — | (3,792) |
| Deferred tax asset valuation allowance | — | — | 692 | — |
| Restructuring costs | (384) | (3) — | (384) | (3) 2,988 (4) |
| Income tax effect of non-GAAP items | (1,579) | (5) (1,580) | (6) (5,593) | (5) (3,810) |
| Adjusted net (loss) income | \$(2,947) | \$2,052 | \$(5,230) | \$4,814 |

(1) Includes litigation costs of \$0.9 million for the three months ended.

(2) Includes litigation costs of \$2.9 million, write off of office facility depreciation of \$0.3 million and severance costs of \$0.5 million for the nine months ended. For comparability, amounts have been reclassified where appropriate, to conform to current period presentation.

(3) Includes \$0.4 million of cash collected on previously written off bad debt.

(4) Includes approximately \$1.7 million of termination costs associated with a large customer contract that ended in 2015 and \$1.3 million of severance and other associated costs.

(5) Our non-GAAP income tax effect uses a long-term projected tax rate of 35%.

(6) Our non-GAAP income tax effect was based on the effective tax rate, excluding discrete items.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements 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.

We believe that the assumptions and estimates associated with revenue recognition, depreciation, stock-based compensation, accounts receivable, the valuation of goodwill and intangible assets, income taxes and legal contingencies have the greatest potential impact on our consolidated financial statements. We evaluate these estimates on an ongoing basis. Actual results could differ from those estimates under different assumptions or conditions, and any differences could be material. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating the reported consolidated financial results include the following:

Revenue Recognition

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

cases, the number of orders placed via our online engagement solutions.

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

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

We recognize monthly service revenue based upon the fee charged for the LivePerson services, provided that there is persuasive evidence of an arrangement, no significant obligations remain, collection of the resulting receivable is probable and the amount of fees to be paid is fixed or determinable. Our service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days’ notice without penalty. When professional service fees add value to the customer on a standalone basis, we recognize professional service fees upon completion of services. 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 the contracted period.

For revenue from our Consumer segment generated from online transactions between Experts and Users, we recognize revenue net of Expert fees in accordance with ASC 605-45, “Principal Agent Considerations,” due primarily to the fact that the Expert is the primary obligor. Additionally, we perform as an agent without any risk of loss for collection, and are not involved in selecting the Expert or establishing the Expert’s fee. We collect a fee from the consumer and retain a portion of the fee, and then remit the balance to the Expert. Revenue from these transactions is recognized when there is persuasive evidence of an arrangement, no significant 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, 2016, there was approximately \$8.4 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted average period of approximately 2.0 years. As of September 30, 2016, there was approximately \$10.3 million of total unrecognized compensation cost related to nonvested restricted stock units. That cost is expected to be recognized over a weighted average period of approximately 3.0 years.

Accounts Receivable

Our customers are located primarily in the United States. We perform ongoing credit evaluations of our customers’ financial condition (except for customers who purchase the LivePerson services by credit card via Internet download) and have established an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information that we believe to be reasonable, although they may change in the future. If there is a deterioration of a customer’s credit worthiness or actual write-offs are higher than our historical experience, our estimates of recoverability for these receivables could be adversely affected. Although our large number of customers limits our concentration of credit risk we do have several large customers. If we experience a significant write-off from one of these large customers, it could have a material adverse impact on our condensed consolidated financial statements. No single customer accounted for or exceeded 10% of our total revenue in the nine months ended September 30, 2016 and 2015. No individual customer accounted for 10% or more of accounts receivable as of September 30, 2016 and December 31, 2015. During the nine months ended September 30, 2016, our allowance for doubtful accounts increased by \$0.6 million primarily due to analysis of the accounts receivable aging.

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

Goodwill

In accordance with ASC 350, “Goodwill and Other Intangible Assets,” goodwill and indefinite-lived intangible assets are not amortized, but reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value below its carrying amount. Goodwill is required to be tested for impairment at least annually. In September 2011, 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) then it is necessary to perform the second step of the goodwill impairment test. The second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining

the fair value of other intangible assets. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. We perform internal valuation analysis and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions including projected future cash flows (including timing), discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, determination of appropriate market comparables and the determination of whether a premium or discount should be applied to such comparables.

We evaluate for goodwill impairment annually at September 30th. At the end of the third quarter of 2016, we determined that it was not more-likely that the fair value of the reporting units are less than their carrying amount. Accordingly, we did not perform the two-step goodwill impairment test.

Impairment of Long-Lived Assets

In accordance with ASC 360-10, "Accounting for the Impairment or Disposal of Long-lived Assets," long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. We do not have any long-lived assets, including intangible assets, which we consider to be impaired.

Legal Contingencies

We are subject to legal proceedings and litigation arising in the ordinary course of business. Periodically, we evaluate the status of each legal matter and assess our potential financial exposure. If the potential loss from any legal proceeding or litigation is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment is required to determine the probability of a loss and whether the amount of the loss is reasonably estimable. The outcome of any proceeding is not determinable in advance. As a result, the assessment of a potential liability and the amount of accruals recorded are based only on the information available at the time. As additional information becomes available, we reassess the potential liability related to the legal proceeding or litigation, and may revise our estimates. Any revisions could have a material effect on our results of operations. See Note 13, Legal Matters, of the Notes to the Consolidated Financial Statements for additional information on our legal proceedings and litigation.

Recently Issued Accounting Standards

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). Topic 230 addresses the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods. We are in the process of evaluating the impact of adoption of ASU 2016-15 on our financial statements.

In March 2016, FASB issued Accounting Standards Update No. 2016-09, "Compensation -Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). This update is intended to improve the accounting for employee share-based payments and affects all organizations that issue share-based payment awards to their employees. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. ASU 2016-09 is effective for financial statements issued for annual periods beginning after December 15, 2016. We are currently in the process of evaluating the impact of adoption of ASU 2016-09 on our financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, "Leases" ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new lease guidance also simplified the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees will no longer be provided with a source of off-balance sheet financing. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. ASU 2016-02 is effective for financial statements issued for annual periods beginning after December 15, 2018. We are currently in the process of evaluating the impact of adoption of ASU 2016-02 on our financial statements.

In November 2015, FASB issued Accounting Standards Update No. 2015-17, "Income taxes: Balance Sheet Classification of Deferred Taxes Business" ("ASU 2015-17"). Topic 740, Income Taxes, requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting. Deferred tax liabilities and assets that are not related to an asset or liability for financial reporting are classified according to the expected reversal date of the temporary difference. To simplify the presentation of deferred income taxes, ASU 2015-17 requires that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. We have elected to early adopt ASU 2015-17 on our financial statements during the second quarter of 2016 on a prospective basis.

In September 2015, FASB issued Accounting Standards Update No. 2015-16, "Business Combinations: Simplifying the Accounting for Measurement-Period Adjustments" ("ASU 2015-16"). ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in ASU 2015-16 require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 is effective for annual reporting periods beginning after December 15, 2015. This standard became effective in the first quarter of 2016, and is applied on a prospective basis to adjustments to provisional amounts that occur after the effective date with no impact to our financial statements.

In February 2015, FASB issued Accounting Standards Update No. 2015-02, Consolidation: Amendments to the Consolidation Analysis ("ASU 2015-02"), which affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The standard amends the consolidation requirements in ASC 810. ASU 2015-02 is effective for fiscal periods beginning after December 15, 2015 for public companies, and early adoption is permitted. We adopted this standard during the first quarter of 2016 and there was no material impact on our financial statements.

In May 2014, FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which supersedes most existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition

methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). In March 2016, the FASB issued implementation guidance that clarified the considerations in principal versus agent determination. In April 2016, the FASB issued guidance that clarified identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. In May 2016, FASB issued guidance that addresses narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. We will adopt this guidance at the beginning of its first quarter of fiscal year 2018. Adoption of this guidance is not expected to have a material impact on our 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, quarterly or annual fee, which varies by service and customer usage. The majority of our larger customers also pay a professional services fee related to implementation and ongoing optimization services. 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 93% of total revenue for the three and nine months ended September 30, 2016 and 94% of total revenue for the three and nine months ended September 30, 2015. Revenue attributable to our monthly hosted Business services accounted for 88% and 89% of total Business revenue for the three and nine months ended September 30, 2016, respectively, and 90% for the three and nine months ended September 30, 2015. Our service agreements typically have twelve month terms and, in some cases, are terminable or may terminate upon 30 to 90 days' notice without penalty. Given the time required to schedule training for our customers' operators and our customers' resource constraints, we have historically experienced a lag between signing a customer contract and recognizing revenue from that customer. Although this lag typically ranges from 30 to 90 days, it may take more or less time between contract signing and recognizing revenue in certain situations.

Revenue from our Consumer segment is generated from online transactions between Experts and Users and is recognized net of Expert fees and accounted for approximately 7% of total revenue for the three and nine months ended September 30, 2016 and 6% of total revenue for the three and nine months ended September 30, 2015.

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

Costs and Expenses

Our cost of revenue consists of:

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

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

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

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

During the nine months ended September 30, 2016, our allowance for doubtful accounts increased by \$0.6 million to approximately \$1.7 million primarily due to analysis of the accounts receivable aging. During 2015, we increased our allowance for doubtful accounts by \$0.7 million to approximately \$1.2 million, principally due to an increase in the proportion of receivables due as a result of an increase in sales. A large proportion of receivables are due from larger corporate customers that typically have longer payment cycles. We base our allowance for doubtful accounts on

specifically identified credit risks of customers, historical trends and other information that we believe to be reasonable. We adjust our allowance for doubtful accounts when accounts previously reserved have been collected.

Non-Cash Compensation Expense

The net non-cash compensation amounts are as follows:

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------|--------------------|---------|-------------------|---------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| | (in thousands) | | (in thousands) | |
| Stock-based compensation expense | \$2,255 | \$2,886 | \$7,600 | \$8,793 |

Results of Operations

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 Experts and Users seeking information and knowledge for a fee via real-time chat.

Comparison of the Three and Nine Months Ended September 30, 2016 and 2015

Revenue

| | Three Months Ended | | | Nine Months Ended | | |
|---------------------|--------------------|----------|----------|-------------------|-----------|----------|
| | September 30, | | | September 30, | | |
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (in thousands) | | | (in thousands) | | |
| Revenue by Segment: | | | | | | |
| Business | \$50,474 | \$57,096 | (12)% | \$154,614 | \$168,642 | (8)% |
| Consumer | 4,044 | 3,661 | 10 % | 12,048 | 11,219 | 7 % |
| Total | \$54,518 | \$60,757 | (10)% | \$166,662 | \$179,861 | (7)% |

Business revenue decreased by 12% to \$50.5 million in the three months ended September 30, 2016, from \$57.1 million in the comparable period in 2015. The decrease is primarily attributable to the decrease in revenue from existing customers by approximately \$7.7 million, revenue that is variable based on pay for performance, and interactions and usage of approximately \$2.7 million; offset partially by the increase of revenue from new customers and professional services of approximately \$3.7 million. Overall decrease in business revenue is primarily attributable to delays in anticipated upsells and increases in cancellations from existing customers. This is a reflection of the rapid pace of migrations, and migration commitments we have seen in recent months, as customers typically prefer to complete upgrades before expanding services. Additionally, there was also a foreign exchange impact primarily tied to the British Pound.

Consumer revenue increased by 10% to \$4.0 million in the three months ended September 30, 2016, from \$3.7 million in the comparable period in 2015. The variance was driven by an increase in chat minutes along with an increase in gross fees and a decrease in fees charged by experts.

Business revenue decreased by 8% to \$154.6 million in the nine months ended September 30, 2016, from \$168.6 million in the comparable period in 2015. The decrease is primarily attributable to the decrease in revenue from existing customers by approximately \$20.0 million and revenue that is variable based on pay for performance, interactions and usage of approximately \$3.1 million; offset partially by the increase of revenue from new customers of approximately \$8.1 million and professional services of approximately \$0.9 million. Overall decrease in business revenue is primarily attributable to delays in anticipated upsells and increases in cancellations from existing customers. This is a reflection of the rapid pace of migrations, and migration commitments we have seen in recent months, as customers typically prefer to complete upgrades before expanding services. Additionally, there was also a foreign exchange impact primarily tied to the British Pound.

Consumer revenue increased by 7% to \$12.0 million in the nine months ended September 30, 2016, from \$11.2 million in the comparable period in 2015. The variance was driven by an increase in chat minutes along with an increase in gross fees and a decrease in fees charged by experts.

Cost of Revenue - Business

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

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| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|----------|-------------|------------------------------------|----------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Cost of revenue - business | \$14,215 | \$17,652 | (19)% | \$46,145 | \$50,752 | (9)% |
| Percentage of total revenue | 26 | % 29 | % | 28 | % 28 | % |
| Headcount (at period end): | 251 | 263 | (5)% | 251 | 263 | (5)% |
| Cost of revenue decreased by 19% to \$14.2 million in the three months ended September 30, 2016, from \$17.7 million in the comparable period in 2015. This decrease in expense is primarily attributable to a decrease in outside labor provider fees and other business services of approximately \$2.3 million, depreciation and amortization by \$0.7 million, and primary and backup server facilities and allocated overhead by \$0.4 million. | | | | | | |
| Cost of revenue decreased by 9% to \$46.1 million in the nine months ended September 30, 2016, from \$50.8 million in the comparable period in 2015. This decrease in expense is primarily attributable to a decrease in outside labor provider fees and business services of approximately \$4.9 million, depreciation and amortization by \$0.5 million, and primary and backup server facilities and allocated overhead by \$0.1 million. | | | | | | |

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.

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|-------|-------------|------------------------------------|---------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Cost of revenue - consumer | \$622 | \$573 | 9 % | \$2,065 | \$1,779 | 16 % |
| Percentage of total revenue | 1 | % 1 | % | 1 | % 1 | % |
| Headcount (at period end) | 18 | 17 | 6 % | 18 | 17 | 6 % |
| Cost of revenue remained relatively flat at \$0.6 million in the three months ended September 30, 2016 and 2015. | | | | | | |
| Cost of revenue increased by 16% to \$2.1 million in the nine months ended September 30, 2016 from \$1.8 million in the comparable period in 2015. This increase in expense is due to increases in outsourcing and other business services of approximately \$0.2 million and credit card processing and other bank fees of approximately \$0.1 million. | | | | | | |

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.

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|--------------------------------|-------------------------------------|----------|-------------|------------------------------------|----------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Sales and marketing - business | \$20,278 | \$21,333 | (5)% | \$62,606 | \$66,865 | (6)% |
| Percentage of total revenue | 37 | % 35 | % | 38 | % 37 | % |
| Headcount (at period end): | 317 | 356 | (11)% | 317 | 356 | (11)% |

Sales and marketing expenses decreased by 5% to \$20.3 million in the three months ended September 30, 2016, from \$21.3 million in the comparable period in 2015. The decrease was primarily due to advertising expense of approximately \$1.5 million and compensation and related costs for sales and marketing personnel of \$0.4 million directly related to a decrease in headcount as result of our increased focus on strengthening our profitability as the scalability of our operating model and recent investments materialize. This was partially offset by outsourced labor

and other business services of approximately \$1.1 million.

Sales and marketing expenses decreased by 6% to \$62.6 million in the nine months ended September 30, 2016, from \$66.9 million in the comparable period in 2015. The decrease was primarily due to compensation and related costs for sales and marketing personnel of approximately \$5.9 million and advertising expense of \$0.8 million directly related to a decrease in

headcount as result of our increased focus on strengthening our profitability as the scalability of our operating model and recent investments materialize. This was partially offset by an increase in business services expense of approximately \$2.7 million.

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.

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|--------------------------------|-------------------------------------|----------|-------------|------------------------------------|----------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Sales and marketing - consumer | \$ 1,789 | \$ 1,953 | (8)% | \$ 5,225 | \$ 5,097 | 3 % |
| Percentage of total revenue | 3 | % 3 | % | 3 | % 3 | % |
| Headcount (at period end): | 10 | 8 | 25 % | 10 | 8 | 25 % |

Sales and marketing expenses decreased by 8% to \$1.8 million in the three months ended September 30, 2016 from \$2.0 million to the comparable period in 2015. The decrease was attributable to advertizing expense of approximately \$0.1 million, and compensation and related expenses for sales and marketing personnel and outsourcing and subcontracted labor of \$0.1 million.

Sales and marketing expenses increased by 3% to \$5.2 million in the nine months ended September 30, 2016, from \$5.1 million in the comparable period in 2015. This increase is primarily attributable to an increases in advertising expenses of approximately \$0.2 million.

General and Administrative

Our general and administrative expenses consist of compensation and related expenses for executive, accounting, legal, human resources and administrative personnel, professional fees and other general corporate expenses.

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------------|-------------------------------------|----------|-------------|------------------------------------|-----------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| General and administrative | \$ 10,069 | \$ 6,587 | 53 % | \$ 29,758 | \$ 27,057 | 10 % |
| Percentage of total revenue | 18 | % 11 | % | 18 | % 15 | % |
| Headcount (at period end): | 113 | 112 | 1 % | 113 | 112 | 1 % |

General and administrative expenses increased by 53% to \$10.1 million in the three months ended September 30, 2016 from \$6.6 million in the comparable period in 2015. This increase is primarily attributable to the contingent earn-outs fair value re-measurement adjustments assessed in connection with our acquisitions of approximately \$3.1 million for the three months ended September 30, 2015 which was recorded in operating income as a decrease to general and administrative expenses. Furthermore, there was an increase in one time litigation costs of approximately \$0.9 million and allocated occupancy costs, related overhead, and other general corporate expenses of approximately \$0.6 million. This was partially offset by decreases in professional fees of \$0.7 million and in salary and related employee expenses of \$0.6 million.

General and administrative expenses increased by 10% to \$29.8 million in the nine months ended September 30, 2016 from \$27.1 million in the comparable period in 2015. This increase is primarily attributable to the contingent earn-outs fair value re-measurement adjustments assessed in connection with our acquisitions of approximately \$3.8 million for the nine months ended September 30, 2015 which was recorded in operating income as a decrease to general and administrative expenses. Furthermore, there was an increase in one time litigation costs of approximately \$2.9 million and allocated occupancy costs, related overhead, and other general corporate expenses of approximately \$0.4 million. This was partially offset by decreases in professional fees of \$2.5 million and in salary and related employee expenses of \$2.0 million.

Product Development

Our product development expenses consist 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.

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------------|-------------------------------------|---------|-------------|------------------------------------|----------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Product development | \$9,495 | \$9,567 | (1)% | \$29,428 | \$29,476 | — % |
| Percentage of total revenue | 17 % | 16 % | | 18 % | 16 % | |
| Headcount (at period end): | 312 | 259 | 20 % | 312 | 259 | 20 % |

Product development costs decreased by 1% to \$9.5 million in the three months ended September 30, 2016, from \$9.6 million in the comparable period in 2015. This decrease relates to compensation, outside labor, and associated costs for existing product development personnel of approximately \$0.4 million, partially offset by increases in allocated occupancy costs and related overhead expenses by \$0.3 million. During the three months ended September 30, 2016, payroll expenses of approximately \$1.0 million were capitalized as it related to internally developed software.

Product development costs remained relatively flat in the nine months ended September 30, 2016 when compared to the same period in 2015. There were decreases in compensation, outside labor, and associated costs for existing product development personnel of approximately \$0.3 million offset by increases in allocated occupancy costs and related overhead expenses by \$0.3 million. During the nine months ended September 30, 2016, payroll expenses of approximately \$1.0 million were capitalized as it related to internally developed software.

Restructuring Costs

Restructuring costs consist of termination costs associated with a large customer contract that ended, as well as re-prioritizing and reallocating resources to focus on areas showing high growth potential.

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------------|-------------------------------------|------|-------------|------------------------------------|---------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Restructuring Costs | \$(384) | \$ — | —% | \$(384) | \$2,988 | (113)% |
| Percentage of total revenue | (1)% | —% | | — % | 2 % | |

Restructuring costs incurred during the nine months ended September 30, 2015 amounted to approximately \$3.0 million. This consisted of approximately \$1.7 million of termination costs associated with a large customer contract that ended in 2015 and \$0.8 million of severance and other associated costs. During the three and nine months ended September 30, 2016, \$0.4 million of cost that were previously written off was collected.

Amortization of Purchased Intangibles

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---------------------------------------|-------------------------------------|---------|-------------|------------------------------------|---------|-------------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| | (\$ in thousands) | | | (\$ in thousands) | | |
| Amortization of purchased intangibles | \$1,013 | \$1,193 | (15)% | \$2,954 | \$3,683 | (20)% |
| Percentage of total revenues | 2 % | 2 % | | 2 % | 2 % | |

Amortization expense for purchased intangibles decreased by 15% to \$1.0 million in the three months ended September 30, 2016 from \$1.2 million in the comparable period in 2015. The decrease is primarily attributable to the full amortization of Engage technology intangible, along with continued amortization of our 2014 acquisitions of

CAO!, Synchronite and our investments in technology licenses.

Amortization expense for purchased intangibles decreased by 20% to \$3.0 million in the nine months ended September 30, 2016 from \$3.7 million in the comparable period in 2015. The decrease is primarily attributable to the full amortization of Look.Io, NexGraph and Engage technology intangible, along with continued amortization of our 2014 acquisitions of CAO!, Synchronite and our investments in technology licenses.

Additional amortization expense in the amount of \$0.7 million and \$0.8 million and \$2.1 million and \$2.4 million is included in cost of revenue for the three and nine months ended September 30, 2016 and 2015, respectively.

Other Expense

Other expense consists of interest income on cash and cash equivalents, investment income and financial (expense) income which is a result of currency rate fluctuations associated with exchange rate movement of the U.S. dollar against the New Israeli Shekel, British Pound, Euro, Australian Dollar and Japanese Yen.

| Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-------------------------------------|------|-------------|------------------------------------|------|-------------|
| 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| (\$ in thousands) | | | (\$ in thousands) | | |

Other expense \$(123) \$(369) (67)% \$(135) \$(371) (64)%

The variance in other expense in the three and nine months ended September 30, 2016 from the comparable period in 2015 is attributable to a increase in financial income from currency exchange and hedging of approximately \$0.3 million.

Provision For (Benefit From) Income Taxes

| Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-------------------------------------|------|-------------|------------------------------------|------|-------------|
| 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| (\$ in thousands) | | | (\$ in thousands) | | |

Provision for (benefit from) income taxes \$3,177 \$(395) (904)% \$5,038 \$(2,721) (285)%

Provision for income taxes is approximately \$3.2 million and \$5.0 million for the three and nine months ended September 30, 2016, respectively, a decrease from the tax benefit from income taxes of \$0.4 million and \$2.7 million for the three and nine months ended September 30, 2015, respectively. Our consolidated effective tax rate is impacted by the statutory income tax rates applicable to each of the jurisdictions in which we operate. During the three months ended September 30, 2016, we incurred a higher overall tax expense due to a larger increase in the taxable income in foreign jurisdictions in relation to the overall loss and the adjustment of prior net operating losses.

Net (Loss)/Income

We had net losses of \$5.9 million and \$16.3 million for the three and nine months ended September 30, 2016, respectively, compared to net income of \$1.9 million and net loss of \$5.5 million for the three and nine months ended September 30, 2015, respectively. During the three months ended September 30, 2016, revenue decreased by approximately \$6.2 million and operating expenses decreased by \$1.8 million. Other expense decreased by \$0.2 million and the provision for (benefit from) income taxes increased by \$3.6 million, contributing to an increase in net loss of \$7.8 million. During the nine months ended September 30, 2016, revenue decreased by approximately \$13.2 million and operating expenses decreased by \$9.9 million. Other expense decreased by \$0.2 million and the provision for (benefit from) income taxes increased by \$7.8 million, contributing to an increase in net loss of \$10.8 million.

Liquidity and Capital Resources

Nine Months
Ended
September 30,
2016 2015
(in thousands)

Consolidated Statements of Cash Flows Data:

| | | |
|---------------------------------------------|-----------|-----------|
| Cash flows provided by operating activities | \$ 16,550 | \$ 10,865 |
| Cash flows used in investing activities | (8,219) | (16,597) |
| Cash flows used in financing activities | (4,935) | (2,014) |

As of September 30, 2016, we had approximately \$51.4 million in cash and cash equivalents, an increase of approximately \$2.6 million from December 31, 2015. The increase is primarily attributable to a decrease in net cash used in investing activities relating to purchases of fixed assets related to the build-out of our co-location facility as well as cash held for collateral for foreign exchange fund contracts when compared to 2015 and to an increase in net cash provided by operating activities relating to movement towards larger and annual contracts. This is offset partially by an increase in repurchase of common stock.

Net cash provided by operating activities was \$16.6 million for the nine months ended September 30, 2016 and consisted primarily of net loss, non-cash expenses related to ASC 718-10, amortization of purchased intangibles and depreciation, increases in deferred revenue and prepaid expenses, and decreases in accounts receivable, accounts payable, and accrued expenses. Net cash provided by operating activities was \$10.9 million for the nine months ended September 30, 2015 and consisted primarily of net loss, non-cash expenses related to ASC 718-10, amortization of purchased intangibles and depreciation, an increase in accounts receivable, prepaid expenses, and a decrease in accounts payable and deferred revenue.

Net cash used in investing activities was \$8.2 million in the nine months ended September 30, 2016 and was due primarily to the purchase of fixed assets for our co-location facilities and partial release of restricted cash used with foreign currency forward contracts. Net cash used in investing activities was \$16.6 million in the nine months ended September 30, 2015 and was due primarily to the purchase of fixed assets for our co-location facilities and restricted cash associated with foreign currency forward contracts.

Net cash used in financing activities was \$4.9 million in the nine months ended September 30, 2016 and consisted primarily of the repurchase of our common stock offset partially by issuance of common stock. Net cash provided by financing activities was \$2.0 million in the nine months ended September 30, 2015 and consisted primarily of the issuance of common stock and excess tax benefit for exercise of employee stock options, offset by the repurchase of our common stock and acquisition related payments.

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 purchased intangible assets, as well as non-cash compensation costs. Historically, we incurred significant quarterly net losses from inception through June 30, 2003, significant negative cash flows from operations in our quarterly periods from inception through December 31, 2002 and negative cash flows from operations of \$0.1 million in the quarterly period ended March 31, 2004. We also incurred a net loss and negative cash flow from operations in the quarterly periods ended March 31, 2014, June 30, 2014, March 31, 2015, June 30, 2015, December 31, 2015, and March 31, 2016. We incurred a net loss in the quarterly periods ended June 30, 2013, September 30, 2013, December 31, 2013, as well as in the quarterly periods ended September 30, 2014, December 31, 2014, March 31, 2015, June 30, 2015, December 31, 2015, March 31, 2016, June 30, 2016, and September 30, 2016. As of September 30, 2016, we had an accumulated deficit of approximately \$135.4 million.

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 twelve (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 or acquire 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, 2016 was approximately \$2.4 million and \$7.6 million, respectively. Rental expense for operating leases for the three and nine months ended September 30, 2015 was approximately \$2.4 million and \$5.9 million, respectively.

As of September 30, 2016, our principal commitments were approximately \$29.8 million under various operating leases, of which approximately \$2.1 million is due in 2016. We currently expect that our principal commitments for the year ending December 31, 2016 will not exceed \$10.0 million in the aggregate.

Our contractual obligations at September 30, 2016 are summarized as follows:

Payments due by period
(in thousands)

| Contractual Obligations | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
|-------------------------|----------|---------------------|-----------|-----------|----------------------|
| Operating leases | \$29,798 | \$ 8,163 | \$ 13,541 | \$ 4,923 | \$ 3,171 |
| Total | \$29,798 | \$ 8,163 | \$ 13,541 | \$ 4,923 | \$ 3,171 |

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Exchange Risks

As a result of the expanded scope of our Israeli operations, our currency rate fluctuation risk associated with the exchange rate movement of the U.S. dollar against the New Israeli Shekel ("NIS") has increased. During the three and nine months ended September 30, 2016, the U.S. dollar depreciated by approximately 2% as compared to the NIS. During the three and nine months ended September 30, 2016, expenses generated by our Israeli operations totaled approximately \$14.4 million and \$43.4 million, respectively. During 2016, we hedged this foreign currency risk exposure along with the hedging of the U.S dollar against the Euro, the British Pound ("GBP"), and the Australian Dollar ("AUD"). We actively monitor the movement of the U.S. dollar against the NIS, the British Pound, Euro, AUS dollar and Japanese Yen 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 continue to 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; the functional currency of our operations in the United Kingdom is the British Pound; the functional currency of our operations in the Netherlands, Germany, Italy and France is the Euro; the functional currency of our operations in Australia is the Australian Dollar; and the functional currency of our operations in Japan is the Japanese Yen.

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, 2016, our allowance for doubtful accounts increased by \$0.6 million to approximately \$1.7 million primarily due to analysis of the accounts receivable aging. During 2015, we decreased our allowance for doubtful accounts from \$1.3 million to approximately \$1.2 million, principally due to an increase in write-offs compared to 2014. 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.

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.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial conditions or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results

of operations.

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, 2016. Based on that evaluation, the Chief Executive Officer and

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Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2016 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, 2016 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

We filed an intellectual property suit against [24]7 Customer, Inc. in the Southern District of New York on March 6, 2014 seeking damages on the grounds that [24]7 reverse engineered and misappropriated our technology to develop competing products and misused our business information. Discovery in the New York case is in process. On June 22, 2015, [24]7 Customer, Inc. filed suit against us in the Northern District of California alleging patent infringement. On December 7, 2015, [24]7 Customer Inc. filed a second patent infringement suit against us, also in the Northern District of California. On January 5, 2016, the two California cases were consolidated for all pre-trial purposes. We believe the claims filed by [24]7 Customer Inc. are without merit and intend to defend them vigorously.

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

From time to time, third parties assert claims against us regarding intellectual property rights, privacy issues and other matters arising in the ordinary course of business. Although we cannot be certain of the outcome of any litigation or the disposition of any claims, nor the amount of damages and exposure, if any, that we could incur, we currently

believe that the final disposition of all existing matters will not have a material adverse effect on our business, results of operations, financial condition or cash flows. In addition, in the ordinary course of our business, we are also subject to periodic threats of lawsuits, investigations and claims. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties, including those described in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, filed on March 15, 2016, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

We are supplementing those risk factors by adding the risk factor set forth below.

Economic conditions and regulatory changes caused by the United Kingdom’s likely exit from the European Union could negatively impact our business.

The United Kingdom (“U.K.”) held a referendum on June 23, 2016 on its membership in the European Union (“E.U.”), in which a majority of U.K. voters voted to exit the E.U. (commonly referred to as “Brexit”). The referendum was advisory, and the terms of any withdrawal are subject to a negotiation period that could last at least two years after the government of the U.K. formally initiates a withdrawal process. These negotiations will determine the future terms of the U.K.’s relationship with the E.U., including the terms of trade between the U.K. and the E.U.

The announcement of Brexit has resulted in significant volatility in global stock market and currency exchange rate fluctuations that resulted in strengthening of the U.S. dollar relative to other foreign currencies in which we conduct business. The announcement of Brexit and likely withdrawal of the U.K. from the E.U. has also created global economic uncertainty, which may cause our customers to closely monitor their costs and reduce their spending budgets. This could negatively impact our business, including affecting our relationships with our existing and future customers, suppliers and employees, which could have a negative impact on our business, prospects, results of operations, financial condition and cash flows.

The effects of Brexit will depend on any agreements the U.K. makes to retain access to E.U. markets either during a transitional period or more permanently. The measures could potentially disrupt the markets we serve and the tax jurisdictions in which we operate and adversely change tax benefits or liabilities in these or other jurisdictions, and may cause us to lose customers, suppliers and/or employees. In addition, Brexit could lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which E.U. laws to replace or replicate. Any of these effects of Brexit, among others, could negatively impact our business, prospects, results of operations, financial condition and cash flows.

Except as otherwise described herein, there were no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

None.

Purchase of Equity Securities by the Issuer

A summary of our repurchase activity for the three months ended September 30, 2016 appears below:

| Period | Total Number of Shares Purchased (1) (2) | Average Price Paid per Share (1) (2) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) (2) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) (2) (3) |
|--------|------------------------------------------------|-----------------------------------------|------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|
|--------|------------------------------------------------|-----------------------------------------|------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|

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| | | | | |
|------------------------------|---------|---------|--|---------------|
| | | | | \$ 15,531,870 |
| 7/1/2016 – 7/31/2016— | \$ — | — | | 15,531,870 |
| 8/1/2016 – 8/31/2016 189,576 | 6.34 | 189,576 | | 14,329,958 |
| 9/1/2016 – 9/30/2016— | — | — | | 14,329,958 |
| Total 189,576 | \$ 6.34 | 189,576 | | \$ 14,329,958 |

(1) On December 10, 2012, we announced that our Board of Directors approved a share repurchase program through June 30, 2014. Under the stock repurchase program, we were authorized to repurchase shares of the our common

stock, in the open market or privately negotiated transactions, at times and prices considered appropriate by the Board of Directors depending upon prevailing market conditions and other corporate considerations.

As of June 30, 2014, approximately \$1.1 million remained available for purchases under the program as in effect at that time. On July 23, 2014, our Board of Directors extended the expiration date of the program out to December 31, 2014 and also increased the aggregate purchase price of the stock repurchase program from \$40.0 million to (2) \$50.0 million. On March 5, 2015, our Board of Directors extended the expiration date of the program out to December 31, 2016. On February 16, 2016, our Board of Directors increased the aggregate purchase price of the total stock repurchase program by an additional \$14.0 million. As of September 30, 2016, approximately \$14.3 million remained available for purchases under the program.

(3) Transaction fees related to the share purchases are deducted from the total remaining allowable expenditure amount.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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 or 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, 2016 By: /s/ ROBERT P. LOCASCIO

Name: Robert P. LoCascio

Title: Chief Executive Officer (principal executive officer)

Date: November 9, 2016 By: /s/ DANIEL R. MURPHY

Name: Daniel R. Murphy

Title: Chief Financial Officer (principal financial and accounting officer)

EXHIBIT INDEX

Number Description

| | |
|----------|--------------------------------------------------------------------------------------------------------------------------------------------------------|
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