

LIVEPERSON INC  
Form 10-Q  
November 09, 2018

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, 2018

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 every Interactive Data File required to be submitted 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 such files). Yes ✓ No ☐

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

Large accelerated filer ☐ Accelerated filer ✓

Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 5, 2018, 63,415,683 shares of the registrant's common stock were outstanding.

LIVEPERSON, INC.  
 September 30, 2018  
 FORM 10-Q  
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## FORWARD-LOOKING STATEMENTS

STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-Q ABOUT LIVEPERSON, INC. (“LIVEPERSON”) 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 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, 2018	December 31, 2017 (Note 1)
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 66,351	\$ 56,115
Cash held as collateral	—	1,451
Accounts receivable, net of allowance for doubtful accounts of \$1,951 and \$1,318 as of September 30, 2018 and December 31, 2017, respectively	51,727	37,926
Prepaid expenses and other current assets	18,722	7,352
Total current assets	136,800	102,844
Property and equipment, net	39,788	34,705
Intangibles, net	13,249	12,366
Goodwill	85,467	80,531
Deferred tax assets	732	753
Other assets	1,818	1,600
Total assets	\$ 277,854	\$ 232,799
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 6,603	\$ 5,481
Accrued expenses and other current liabilities	41,124	48,011
Deferred revenue	56,117	35,563
Total current liabilities	103,844	89,055
Deferred revenue	2,067	—
Other liabilities	3,972	2,766
Deferred tax liability	1,073	915
Total liabilities	110,956	92,736
Commitments and contingencies		
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock	63	60
Additional paid-in capital	351,702	305,676
Treasury stock	(3	) (3
Accumulated deficit	(181,026	) (163,135
Accumulated other comprehensive loss	(3,838	) (2,535
Total stockholders' equity	166,898	140,063
Total liabilities and stockholders' equity	\$ 277,854	\$ 232,799

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,	
	2018	2017	2018	2017
Revenue	\$ 64,213	\$ 56,493	\$ 184,114	\$ 161,486
Costs and expenses <sup>(1) (2)</sup>				
Cost of revenue <sup>(3)</sup>	15,689	14,541	45,679	43,456
Sales and marketing	26,748	21,603	76,271	66,695
General and administrative	11,972	10,398	33,594	30,528
Product development	13,484	9,726	40,955	29,011
Restructuring costs	722	—	2,806	2,315
Amortization of purchased intangibles	424	470	1,272	1,412
Total costs and expenses	69,039	56,738	200,577	173,417
Loss from operations	(4,826 )	(245 )	(16,463 )	(11,931 )
Other (expense) income , net	(213 )	191	(53 )	412
Loss before provision for income taxes	(5,039 )	(54 )	(16,516 )	(11,519 )
Provision for income taxes	2,004	1,256	2,051	3,000
Net loss	\$ (7,043 )	\$ (1,310 )	\$ (18,567 )	\$ (14,519 )
Net loss per share of common stock:				
Basic	\$ (0.12 )	\$ (0.02 )	\$ (0.32 )	\$ (0.26 )
Diluted	\$ (0.12 )	\$ (0.02 )	\$ (0.32 )	\$ (0.26 )
Weighted-average shares used to compute net loss per share:				
Basic	60,014,246	56,524,990	58,667,289	56,153,428
Diluted	60,014,246	56,524,990	58,667,289	56,153,428

<sup>(1)</sup> Amounts include stock-based  
compensation expense, as follows:

Cost of revenue	\$ 220	\$ 108	\$ 604	\$ 301
Sales and marketing	1,472	576	3,731	1,984
General and administrative	1,368	622	3,390	2,058
Product development	1,014	537	2,613	1,760

<sup>(2)</sup> Amounts include depreciation  
expense, as follows:

Cost of revenue	\$ 1,934	\$ 1,715	\$ 5,781	\$ 5,350
Sales and marketing	388	417	1,115	1,206
General and administrative	275	321	795	911
Product development	960	726	2,652	1,550

<sup>(3)</sup> Amounts include amortization of  
purchased intangibles, as follows:

Cost of revenue	\$ 285	\$ 639	\$ 859	\$ 2,556
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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,	
	2018	2017	2018	2017
Net loss	\$ (7,043 )	\$ (1,310 )	\$ (18,567 )	\$ (14,519 )
Foreign currency translation adjustment	376	317	1,303	(4,301 )
Comprehensive loss	\$ (6,667 )	\$ (993 )	\$ (17,264 )	\$ (18,820 )

See Notes to Condensed Consolidated Financial Statements (unaudited).

## LIVEPERSON, INC.

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

	Nine Months Ended September 30,	
	2018	2017
<b>OPERATING ACTIVITIES:</b>		
Net loss	\$(18,567)	\$(14,519)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Stock-based compensation expense	10,338	6,103
Depreciation	10,343	9,017
Amortization of purchased intangibles	2,131	3,968
Amortization of tenant allowance	(204)	(125)
Deferred income taxes	179	823
Provision for doubtful accounts, net	1,326	1,363
Changes in operating assets and liabilities:		
Accounts receivable	(15,127)	(1,719)
Prepaid expenses and other current assets	(11,370)	(2,248)
Other assets	(218)	75
Accounts payable	571	(4,352)
Accrued expenses and other current liabilities	(8,849)	(2,954)
Deferred revenue	22,381	8,549
Other liabilities	(42)	(463)
Net cash (used in) provided by operating activities	(7,108)	3,518
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment, including capitalized software	(13,832)	(12,176)
Cash held as collateral for foreign exchange forward contracts	1,451	2,511
Payments for acquisitions and intangible assets, net of cash acquired	(1,502)	(345)
Net cash used in investing activities	(13,883)	(10,010)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock in connection with the exercise of options	32,712	7,748
Repurchase of common stock	(1,345)	(1,741)
Net cash provided by financing activities	31,367	6,007
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(140)	3,957
CHANGE IN CASH AND CASH EQUIVALENTS	10,236	3,472
CASH AND CASH EQUIVALENTS - Beginning of the period	56,115	50,889
CASH AND CASH EQUIVALENTS - End of the period	\$66,351	\$54,361
<b>SUPPLEMENTAL DISCLOSURE OF OTHER CASH FLOW INFORMATION:</b>		
Cash paid for income taxes	\$5,524	\$540
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Purchase of property and equipment recorded in accounts payable	\$550	\$507



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Leasehold improvements funded by landlord	\$1,449	\$—
Issuance of 85,861 shares of common stock in connection with the BotCentral transaction on January 24, 2018	\$1,000	\$—
Issuance of 115,385 shares of common stock in connection with the Conversable transaction on September 27, 2018	\$3,000	\$—
Contingent earn-out in connection with the acquisition of Conversable recorded in accrued expenses and common stock	\$2,124	\$—

See Notes to Condensed Consolidated Financial Statements (unaudited).

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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), Austin (Texas), San Francisco (California) and Seattle (Washington), and international offices in Amsterdam (Netherlands), Berlin (Germany), London (United Kingdom), Mannheim (Germany), Melbourne (Australia), Milan (Italy), Paris (France), Ra'anana (Israel), Reading (United Kingdom), Tel Aviv (Israel), and Tokyo (Japan).

LivePerson provides mobile and online business messaging solutions that power digital communication between brands and consumers. LiveEngage, the Company’s enterprise-class, cloud-based platform, enables businesses and consumers to connect through conversational interfaces, such as in-app and mobile messaging, while leveraging bots and artificial intelligence (AI) to increase efficiency. As consumers have reoriented their digital lives around the smartphone, messaging apps have become their preferred communication channel to connect with each other.

LivePerson allows brands to align with this new consumer preference, and deploy messaging at scale for customer care, marketing, and sales, instead of requiring that consumers use email or call a 1-800 number.

LiveEngage was designed to securely deploy messaging, coupled with bots and AI, at scale for brands with tens of millions of customers and many thousands of customer care agents. LiveEngage powers conversations across each of a brand’s primary digital channels, including mobile apps, mobile and desktop web browsers, short message services (SMS), social media and third-party consumer messaging platforms. Brands can also use LiveEngage to message consumers when they dial a 1-800 number instead of having them navigate interactive voice response systems (IVR) and wait on hold. The platform seamlessly integrates with third-party bots, enabling brands to manage both AI- based agents and human agents from a single console.

LivePerson optimizes campaign outcomes for sales and service transactions by combining website visitor data with other historical, behavioral, and operational information to develop insights into each step of a consumer’s journey.

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 real-time chat with individual consumers (“Users”).

Basis of Presentation

The accompanying condensed consolidated financial statements as of September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017 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, 2018, and the consolidated results of operations, comprehensive loss and cash flows for the interim periods ended September 30, 2018 and 2017. 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, 2017 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, 2017 included in the Company’s Annual Report on Form 10-K filed with the SEC on March 15, 2018.

Principles of Consolidation

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

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### 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 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-15 "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract; Disclosures for Implementation Costs Incurred for Internal-Use Software and Cloud Computing Arrangements". This standard aligns the accounting for implementation costs incurred in a hosting arrangement that is a service contract with the accounting for implementation costs incurred to develop or obtain internal-use software under Accounting Standards Codification ("ASC") 350-40, in order to determine which costs to capitalize and recognize as an asset. ASU 2018-15 is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2019, and can be applied either prospectively to implementation costs incurred after the date of adoption or retrospectively to all arrangements. The Company is currently in the process of evaluating the impact of the adoption of ASU 2018-230 on its consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07 "Compensation—Stock Compensation (Topic 718)—Improvements to Nonemployee Share-Based Payment Accounting" ("ASU 2018-07"). This new standard expands the scope of Topic 718, Compensation—Stock Compensation (which currently only includes share-based payments to employees) to include share-based payments issued to non-employees for goods or services. Consequently, the accounting for share-based payments to non-employees and employees will be substantially aligned. ASU 2018-07 is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. The Company is currently evaluating the impact of this updated standard, but does not believe this update will have a significant impact on its consolidated financial statements.

In March 2018, the FASB issued ASU No. 2018-05 "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118" ("ASU 2018-05"). This new standard adds SEC paragraphs pursuant to the SEC Staff Accounting Bulletin No. 118, which expresses the view of the staff regarding application of Topic 740, Income Taxes, in the reporting period that includes December 22, 2017, the date on which the Tax Cuts and Jobs Act (H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018) was signed into law. ASU 2018-05 is effective upon inclusion in the FASB Codification. The Company evaluated the impact of this updated standard and determined that the tax on unremitted earnings is zero due to the overall accumulated deficit in earnings and profits.

In February 2018, the FASB issued ASU No. 2018-02 "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"). This new standard allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. The amendments in ASU 2018-02 affects any entity that is required to apply the provisions of Topic 220 and has items of other comprehensive income for which the related tax effects are presented in other comprehensive income as required by GAAP. ASU 2018-02 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, for public companies. Early adoption is permitted in any interim period or fiscal years before the effective date of the standard. The Company does not expect the adoption of ASU 2018-02 to have a material effect on its financial position, results of operations or cash flows.

In August 2017, the FASB issued ASU No. 2017-12 "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities" ("ASU 2017-12"). This new standard refines and expands hedge accounting for both financial (e.g., interest rate) and commodity risks. Its provisions create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes, for investors and analysts. ASU 2017-12 is effective for fiscal years, and interim periods within those fiscal years, beginning after

December 15, 2018, for public companies. Early adoption is permitted in any interim period or fiscal years before the effective date of the standard. The Company does not expect the adoption of ASU 2017-12 to have a material effect on its financial position, results of operations or cash flows.

In January 2017, FASB issued ASU No. 2017-04, "Intangibles —Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" ("ASU 2017-04"). This update addresses concerns over the cost and complexity of the two-step goodwill impairment test. The amendments in this update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. ASU 2017-04 is effective for financial statements issued for annual periods beginning after December 15, 2019, and interim periods within those annual periods. The Company does not expect the adoption of ASU 2017-04 to have a material effect on its financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU 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. 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) may 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. The Company is currently evaluating adopting the standard using the modified transition approach or the transition option available where the Company would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. ASU 2016-02 is effective for financial statements issued for annual periods beginning after December 15, 2018. The Company is currently assessing the provisions of this guidance and evaluating the timing and impact the guidance will have on its consolidated financial statements and related disclosures. The Company is also in the process of aggregating lease documentation for review. The adoption of this ASU primarily impacts the balance sheet through the recognition of a right-of-use asset and a lease liability for all leases with terms in excess of twelve months. This guidance is effective January 1, 2019 using a modified retrospective transition approach with early adoption permitted.

#### Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" ("Topic 606"). Topic 606 supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition" ("Topic 605"), and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the considerations to which the entity expects to be entitled to in exchange for those goods or services. Topic 606 also includes Subtopic 340-40, "Other Assets and Deferred Costs - Contracts with Customers", which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, the Company refers to Topic 606 and Subtopic 340-40 as the "new standard."

The Company adopted the requirements of the new standard as of January 1, 2018, utilizing the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for the reporting periods beginning after January 1, 2018 are presented under the new standard, while prior period amounts are not adjusted and continue to be reported in accordance with its historic accounting under Topic 605.

The impact of adopting the new standard as of January 1, 2018 on revenues was not material. The primary impact of adopting the new standard relates to the deferral of incremental commission costs of obtaining subscription contracts. The Company recorded an addition to opening retained earnings of \$0.7 million as of January 1, 2018 due to the impact of adopting the new standard, with the impact related to the deferral of incremental commission costs. Under Topic 605, the Company deferred only direct and incremental commission costs to obtain a contract and amortized those costs on a straight-line basis over the term of the related subscription contract, which was generally one year. Under the new standard, the Company defers all incremental commission costs to obtain the contract. The prepaid commission balance as of September 30, 2018 is \$10.9 million. The Company amortizes these costs over the related period of benefit using the customer expected life that the Company determined to be three to five years which is consistent with the transfer to the customer of the services to which the asset relates.

## 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. Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

The Company determines revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, the Company satisfies a performance obligation.

Total revenue of \$64.2 million and \$184.1 million recognized during the three months and nine months ended September 30, 2018, respectively, under Topic 606, was not materially different from what would have been recognized under Topic 605.

#### Hosted Services- Business Revenue

Hosted Services Business revenue is reported at the amount that reflects the ultimate consideration expected to be received and primarily consist of fees that provide customers access to LiveEngage, the Company's enterprise-class, cloud-based platform. The Company has determined such access represents a stand-ready service provided continually throughout the contract term. As such, control and satisfaction of this stand-ready performance obligation is deemed to occur over time. The Company recognizes this revenue over time on a ratable basis over the contract term, beginning on the date that access to the LiveEngage platform is made available to the customer. The passage of time is deemed to be the most faithful depiction of the transfer of control of the services as the customer simultaneously receives and consumes the benefit provided by the Company's performance. Subscription contracts are generally one year or longer in length, billed, monthly, quarterly or annually in advance. There is no significant variable consideration related to these arrangements. Additionally, 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-606, "Principal Agent Considerations", the Company acts as a principal in a transaction if it controls the specified goods or services before they are transferred to the customer.

#### Professional Services Revenues

Professional services revenue primarily consists of fees for deployment and optimization services, as well as training delivered on an on-demand basis which is deemed to represent a distinct stand-ready performance obligation. Professional Services Revenues are reported at the amount that reflects the ultimate consideration the Company expects to receive in exchange for such services. Control for the majority of the Company's Professional Services contracts passes over time to the customer and is recognized ratably over the contracted period, as the passage of time is deemed to be the most faithful depiction of the transfer of control. For certain deployment services, which are not deemed to represent a distinct performance obligation, revenue will be recognized in the same manner as the fee for access to the LiveEngage platform, and as such will be recognized on a straight-line basis over the contract term. For services billed on a fixed price basis, revenue is recognized over time based on the proportion performed using inputs as the measure of progress toward complete satisfaction of the performance obligation. Professional service contracts are generally one year or longer in length, billed, monthly, quarterly or annually in advance. There is no significant variable consideration related to these arrangements.

#### Contracts with Multiple Performance Obligations

Some of the Company's contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. The Company determines the standalone selling prices based on its overall pricing objectives, taking into consideration market conditions and other factors, including the value of its contracts, the cloud applications sold, and the number and types of users within its contracts.

#### Hosted Services- Consumer Revenue



For revenue from the Company's Consumer segment generated from online transactions between Experts and Users, revenue is recognized at an amount net of Expert fees in accordance with ASC 606, "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 consumer and retains a portion of the fee, and then remits the balance to the Expert. Revenue from these transactions is recognized at the point in time when the transaction is complete and no significant performance obligations remain.

#### Deferred Revenues

The Company records deferred revenues when cash payments are received or due in advance of its performance. The increase in the deferred revenue balance for the nine months ended September 30, 2018 is primarily driven by cash payments received or due in advance of satisfying its performance obligations, partially offset by \$31.7 million of revenues recognized that were included in the deferred revenue balance as of December 31, 2017.

The following table presents deferred revenue by revenue source (amounts in thousands):

	Deferred Revenue	
	As of	
	September 30, 2018	December 31, 2017
Hosted services – Business	\$45,225	\$ 27,011
Professional services – Business	10,892	8,552
Total deferred revenue - short term	\$56,117	\$ 35,563
Hosted services – Business	\$ 1,653	\$ —
Professional services – Business	414	—
Total deferred revenue - long term	\$2,067	\$ —

#### Disaggregated Revenue

The following table presents the Company's revenues disaggregated by revenue source (amounts in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Revenue:				
Hosted services – Business	\$50,046	\$46,378	\$145,805	\$131,798
Hosted services – Consumer	4,876	4,355	14,508	12,985
Professional services	9,291	5,760	23,801	16,703
Total revenue	\$64,213	\$56,493	\$184,114	\$161,486

(1) As noted above, prior period amounts have not been adjusted under the modified retrospective method.

#### Revenue by Geographic Location

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, 2018	September 30, 2017	September 30, 2018	September 30, 2017
United States	\$37,033	\$35,519	\$106,676	\$101,282
Other Americas <sup>(1)</sup>	2,402	1,744	6,208	5,684
Total Americas	39,435	37,263	112,884	106,966
EMEA <sup>(2) (4)</sup>	18,536	14,175	52,974	41,640
APAC <sup>(3)</sup>	6,242	5,055	18,256	12,880
Total revenue	\$64,213	\$56,493	\$184,114	\$161,486

(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 \$11.1 million and \$10.2 million for the three months ended September 30, 2018 and 2017, respectively, and \$34.7 million and \$28.4 million nine months ended September 30, 2018 and 2017, respectively.

#### Information about Contract Balances

Amounts collected in advance of services being provided are accounted for as deferred revenue. Nearly all of the Company's deferred revenue balance is related to Hosted Services- Business Revenue.

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In some arrangements, the Company allows customers to pay for access to LiveEngage over the term of the software license. The Company refers to these as subscription transactions. Amounts recognized as revenue in excess of amounts billed are recorded as unbilled receivables. Unbilled receivables, anticipated to be invoiced in the next twelve months, are included in accounts receivable on the consolidated balance sheet. The opening and closing balances of the Company's accounts receivable, unbilled receivables, and deferred revenues are as follows (amounts in thousands):

	Accounts Receivable	Unbilled Receivable	Deferred Revenue (current)	Deferred Revenue (long term)
Opening Balance as of December 31, 2017	\$ 30,342	\$ 7,584	\$ 35,563	\$ —
Increase (decrease), net	10,300	3,501	20,554	2,067
Ending Balance as of September 30, 2018	\$ 40,642	\$ 11,085	\$ 56,117	\$ 2,067

As of September 30, 2018, the Company expects to recognize the long term performance obligations in 2019.

### 3. Net Loss Per Share

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

Diluted net loss per common share for the three and nine months ended September 30, 2018 does not include the effect of 9,168,450 outstanding common stock awards, as the effect of their inclusion is anti-dilutive. Diluted net loss per common share for the three and nine months ended September 30, 2017 does not include the effect of 8,653,000 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,	
	2018	2017	2018	2017
Basic	60,014,246	56,524,990	58,667,289	56,153,428
Effect of assumed exercised options	—	—	—	—
Diluted	60,014,246	56,524,990	58,667,289	56,153,428

### 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 enables brands to leverage LiveEngage’s sophisticated intelligence engine to connect with consumers through an integrated suite of mobile and online business messaging technologies. 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. 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, 2018, 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	\$ 50,046	\$ —	\$—	\$ 50,046
Hosted services – Consumer	—	4,876	—	4,876
Professional services	9,291	—	—	9,291
Total revenue	59,337	4,876	—	64,213
Cost of revenue	14,695	994	—	15,689
Sales and marketing	24,391	2,357	—	26,748
Amortization of purchased intangibles	424	—	—	424
Unallocated corporate expenses	—	—	26,178	26,178
Operating income (loss)	\$ 19,827	\$ 1,525	\$(26,178)	\$ (4,826 )

Summarized financial information by segment for the three months ended September 30, 2017, 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	\$ 46,378	\$ —	\$—	\$ 46,378
Hosted services – Consumer	—	4,355	—	4,355
Professional services	5,760	—	—	5,760
Total revenue	52,138	4,355	—	56,493
Cost of revenue	13,681	860	—	14,541
Sales and marketing	19,554	2,049	—	21,603
Amortization of purchased intangibles	470	—	—	470
Unallocated corporate expenses	—	—	20,124	20,124
Operating income (loss)	\$ 18,433	\$ 1,446	\$(20,124)	\$ (245 )

Summarized financial information by segment for the nine months ended September 30, 2018, 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	\$ 145,805	\$ —	\$—	\$ 145,805
Hosted services – Consumer	—	14,508	—	14,508
Professional services	23,801	—	—	23,801
Total revenue	169,606	14,508	—	184,114
Cost of revenue	42,699	2,980	—	45,679
Sales and marketing	69,453	6,818	—	76,271
Amortization of purchased intangibles	1,272	—	—	1,272
Unallocated corporate expenses	—	—	77,355	77,355
Operating income (loss)	\$ 56,182	\$ 4,710	\$(77,355)	\$ (16,463 )

Summarized financial information by segment for the nine months ended September 30, 2017, 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	\$ 131,798	\$ —	\$ —	\$ 131,798
Hosted services – Consumer	—	12,985	—	12,985
Professional services	16,703	—	—	16,703
Total revenue	148,501	12,985	—	161,486
Cost of revenue	40,794	2,662	—	43,456
Sales and marketing	60,338	6,357	—	66,695
Amortization of purchased intangibles	1,412	—	—	1,412
Unallocated corporate expenses	—	—	61,854	61,854
Operating income (loss)	\$ 45,957	\$ 3,966	\$ (61,854)	\$ (11,931 )

#### Geographic Information

The Company is domiciled in the United States and has international operations in Israel, the United Kingdom, Asia-Pacific and Australia, Latin America and Western Europe, particularly France, Germany and the Netherlands. The following table presents the Company's long-lived assets by geographic region as of the dates presented (amounts in thousands):

	September 30, 2018	December 31, 2017
United States	\$ 108,016	\$ 95,716
Israel	13,490	13,079
Australia	8,744	9,504
Netherlands	7,677	8,363
Other <sup>(1)</sup>	3,127	3,293
Total long-lived assets	\$ 141,054	\$ 129,955

<sup>(1)</sup> 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, 2018 and December 31, 2017.

#### 5. Goodwill and Intangible Assets

##### Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2018 are as follows (amounts in thousands):

	Business	Consumer	Consolidated
Balance as of December 31, 2017	\$ 72,507	\$ 8,024	\$ 80,531
Adjustments to goodwill:			
Acquisitions	5,010	—	5,010
Foreign exchange adjustment	(74 )	—	(74 )
Balance as of September 30, 2018	\$ 77,443	\$ 8,024	\$ 85,467

## Intangible Assets

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

As of September 30, 2018

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Amortization Period
Amortizing intangible assets:				
Technology	\$30,640	\$ (23,221 )	\$ 7,419	5.3 years
Customer relationships	15,971	(11,436 )	4,535	8.0 years
Trade names	1,287	(1,287 )	—	2.1 years
Non-compete agreements	1,437	(1,437 )	—	2.3 years
Patents	1,867	(599 )	1,268	13.4 years
Other	262	(235 )	27	2.7 years
Total	\$51,464	\$ (38,215 )	\$ 13,249	

As of December 31, 2017

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Amortization Period
Amortizing intangible assets:				
Technology	\$27,882	\$ (22,197 )	\$ 5,685	5.3 years
Customer relationships	15,978	(10,457 )	5,521	8.0 years
Trade names	1,289	(1,283 )	6	2.1 years
Non-compete agreements	1,439	(1,439 )	—	2.3 years
Patents	1,620	(493 )	1,127	13.1 years
Other	262	(235 )	27	2.7 years
Total	\$48,470	\$ (36,104 )	\$ 12,366	

Amortization expense is calculated over the estimated useful life of the asset. Aggregate amortization expense for intangible assets was \$0.7 million and \$1.1 million for the three months ended September 30, 2018 and 2017, respectively, and \$2.1 million and \$4.0 million for the nine months ended September 30, 2018 and 2017, respectively. For the three and nine months ended September 30, 2018 and 2017, 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
Remaining 2018	\$ 792
2019	2,963
2020	2,775
2021	2,565
2022	2,216
Thereafter	1,938
Total	\$ 13,249





## 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,	
	2018	2017
Computer equipment and software	\$ 113,463	\$ 100,392
Furniture, equipment and building improvements	15,154	13,546
	128,617	113,938
Less: accumulated depreciation	(88,829 )	(79,233 )
Total	\$ 39,788	\$ 34,705

## 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,	
	2018	2017
Payroll and other employee related costs	\$ 16,942	\$ 16,431
Professional services and consulting and other vendor fees	12,688	15,674
Unrecognized tax benefits	2,332	4,924
Sales commissions	5,719	5,259
Contingent earn-out (see Note 8)	1,800	—
Restructuring (see Note 12)	1,249	2,338
Other	394	3,385
Total	\$ 41,124	\$ 48,011

## 8. Acquisitions

### Conversable, Inc.

In September 2018, the Company acquired the employees and technology assets of Conversable, Inc. a SaaS based Artificial Intelligence powered conversational platform, headquartered in Austin, Texas, for an aggregated estimated purchase price of \$6.6 million. The estimated purchase price consisted of \$1.2 million in cash, approximately \$3.0 million in shares of common stock of the Company, a potential earn-out consideration of \$1.8 million in cash and \$0.3 million of common stock of the Company, and \$0.3 million of deferred revenue. This transaction was accounted for under the purchase method of accounting and was based upon the estimated fair value of Conversable, Inc.'s net tangible and identifiable intangible assets as of the date of acquisition.

The preliminary purchase price allocation resulted in approximately \$5.0 million of goodwill and approximately \$1.6 million of intangible assets. The goodwill will be deductible for tax purposes. The intangible assets are being amortized over their expected period of benefit. There is a potential earn-out consideration payment to Conversable Inc.'s shareholders for \$2.1 million, which is based on achieving certain targeted financial, strategic, and integration objectives. There is another \$0.6 million potential earn-out consideration payment to Conversable Inc.'s employees, which is considered compensation and is being expensed over 12 months. Conversable Inc.'s capabilities will accelerate the ongoing expansion of the Company's conversational commerce solutions and enhance the Company's ability to deliver proactive and personalized content and services when and where the customer needs it, helping consumers find immediate service through messaging.

The Company is in the process of finalizing all fair value and asset purchase accounting adjustments. The effect of this acquisition is included in the Company's results from September 27, 2018 to September 30, 2018 and is not material, thus no pro-forma disclosure is provided.

## BotCentral, Inc.

In January 2018, the Company acquired the employees and technology assets of BotCentral, Inc., a Silicon Valley based startup, for an approximate purchase price of \$1.0 million in common stock of the Company. The Company incurred an additional \$0.2 million related to acquisition costs. This transaction was accounted for as an asset purchase. The aggregate amount of approximately \$1.2 million is included in "Intangibles, net" on the Company's September 30, 2018 condensed consolidated balance sheet. While an active participant in the LiveEngage for Bots partner program, the BotCentral team created a number of bot solutions for major brands in banking, insurance, and travel, running on LivePerson's conversational platform. With the team's expertise and knowledge of the LiveEngage platform, the team is bringing valuable insight for LivePerson's customers and partners, and enabling the company to more rapidly optimize its bot deployment capabilities, and grow the ecosystem.

## 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, 2018 and December 31, 2017, are summarized as follows (amounts in thousands). The Company has no restricted cash balance at September 30, 2018. The Company's restricted cash balance of \$1.5 million at December 31, 2017 was not held in a money market account and is not included in the following table.

	September 30, 2018				December 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Money market funds	\$2,828	\$—	\$—	\$2,828	\$2,806	\$—	\$—	\$—\$2,806
Foreign currency derivative contracts	—	—	—	—	—	65	—	65
Total assets	\$2,828	\$—	\$—	\$2,828	\$2,806	\$65	\$—	\$—\$2,871
Liabilities:								
Contingent earn-out	\$—	\$—	\$—\$1,800	\$1,800	\$—	\$—	\$—	\$—\$—
Foreign currency derivative contracts	—	—	—	—	—	2	—	2
Total liabilities	\$—	\$—	\$—\$1,800	\$1,800	\$—	\$2	\$—	\$—\$2

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

The Company's 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 only liability that is measured at fair value on a recurring basis is the contingent earn-out and is classified as level 3 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 Company recorded a contingent earn-out of \$1.8 million in September 2018 in connection with the acquisition of Conversable, Inc. The contingent earn-out is based on achieving certain targeted financial, strategic, and integration objectives. The unobservable inputs considered are probability factors and the time value of money. See Note 8 of the Notes to Condensed Consolidated Financial Statements for a full description of the acquisition.

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

	Contingent Earn-Out	
	September 30, 2018	December 31, 2017
Balance, Beginning of year	\$—	\$ —
Conversable, Inc. addition (see Note 8)	1,800	—
Cash payment	—	—
Changes in fair value	—	—
Balance, End of year	\$ 1,800	\$ —

#### 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.

As of September 30, 2018, the Company is not party to any foreign currency forward contracts and does not have any restricted cash balance. At December 31, 2017, in accordance with the foreign currency forward contracts, the Company was required to pledge cash as collateral security to be maintained at an Israeli bank. The collateral security would remain in control of the bank, to be available in order to satisfy outstanding obligations under the foreign currency forward contracts. Accordingly, the Company had cash at an Israeli bank of approximately \$1.5 million at December 31, 2017, which is 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, 2018	As of December 31, 2017
Notional amount of foreign currency derivative contracts	\$ —	—\$ 2,866

Fair value of foreign currency derivatives contracts      \$      —\$ 63

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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, 2018	As of December 31, 2017
<b>Derivative Assets</b>			
Derivatives not designated as hedging instruments:			
Foreign currency derivatives contracts	Prepaid expenses and other current assets	\$ —	\$ 65
<b>Derivative Liabilities</b>			
Derivatives not designated as hedging instruments:			
Foreign currency derivatives contracts	Accrued expenses and other liabilities	\$ —	\$ 2

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, 2018	Nine Months Ended September 30, 2017
Foreign currency derivatives contracts	Other (income) expense	\$ — (19 )	\$(50) \$194

## 10. Commitments and Contingencies

### Contractual Obligations

The Company leases facilities and certain equipment under agreements accounted for as operating leases. These leases generally require the Company to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the three months ended September 30, 2018 and 2017 was approximately \$2.9 million and \$2.3 million, respectively. Rental expense for operating leases for the nine months ended September 30, 2018 and 2017 was approximately \$7.2 million and \$7.3 million, respectively.

### Employee Benefit Plans

The Company has a 401(k) defined contribution plan covering all eligible employees. The Company provides for employer matching contributions equal to 50% of employee contributions, up to the lesser of 5% of eligible compensation or \$6,000. Matching contributions are deposited into the employee's 401(k) account and are subject to 5 year graded vesting. Salaries and related expenses include \$0.4 million and \$0.3 million of employer matching contributions for both the three months ended September 30, 2018 and 2017, respectively. Salaries and related expenses include \$1.2 million and \$1.1 million of employer matching contributions for the nine months ended September 30, 2018 and 2017, respectively.

### Letters of Credit

As of September 30, 2018, the Company has a \$1.8 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 nine months ended September 30, 2018.

## 11. Stockholders' Equity

### Common Stock

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As of September 30, 2018, there were 100,000,000 shares of common stock authorized, and 63,201,497 shares issued and outstanding. As of December 31, 2017, there were 100,000,000 shares of common stock authorized, and 59,663,969 shares issued and outstanding. The par value for common shares is \$0.001.

Preferred Stock

As of September 30, 2018 and December 31, 2017, 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 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. On November 21, 2016, the Company's Board of Directors increased the aggregate purchase price of the stock repurchase program from \$64.0 million to \$74.0 million and extended the expiration date of the program out to December 31, 2017. On May 7, 2018, the Company's Board of Directors ratified the extension to December 31, 2018 of the repurchase program, effective as of January 1, 2018. There were 93,750 shares repurchased under this program during the nine months ended September 30, 2018, which were recorded in treasury stock at par on the condensed consolidated balance sheets as of September 30, 2018. As of September 30, 2018, approximately \$17.1 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. 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 was \$10.13 and \$5.02 during the three months ended September 30, 2018 and 2017, respectively, and \$6.62 and \$3.63 during the nine months ended September 30, 2018 and 2017, 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,	
	2018	2017	2018	2017
Dividend yield	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	2.8% - 2.9%	1.8%	2.5% - 2.9%	1.7% - 1.9%
Expected life (in years)	5	5	5	5
Historical volatility	43.5% - 43.7%	47.3%	43.5% - 48.4%	46.6% - 47.6%

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 or other equity-based awards in respect of 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 2000 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 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.

On June 2, 2017, the Company's Board of Directors amended and restated the Amended 2009 Plan effective April 30, 2017. The amended and restated plan increased the number of shares authorized for issuance under the plan by an additional 4,000,000, thereby reserving for issuance 27,817,744 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have 10-year terms. As of September 30, 2018, approximately 2.4 million shares of common stock were reserved for issuance under the Amended 2009 Plan (taking into account all option exercises and other equity award settlements through September 30, 2018).

#### 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. Subject to stockholder approval, which was obtained on June 2, 2017, the Company's Board of Directors amended and restated the 2010 Employee Stock Purchase Plan effective April 30, 2017. The amended and restated plan increased the number of shares authorized for issuance under the plan by an additional 1,000,000, thereby reserving for issuance 2,000,000 shares of common stock in the aggregate. As of September 30, 2018, approximately 0.9 million shares of common stock were reserved for issuance under the Employee Stock Purchase Plan (taking into account all share purchases through September 30, 2018).

#### Inducement Plan

During January 2018, the Company established the Inducement Plan (the "2018 Plan"). Under the 2018 Plan, the Board of Directors can issue incentive stock options or nonqualified stock options or other equity-based awards in respect of up to 1,500,000 shares of common stock. On April 25, 2018, the Company's Board of Directors amended and restated the 2018 Plan (the "Amended 2018 Plan"). The Amended 2018 Plan increased the number of shares authorized for issuance under the plan by an additional 500,000 shares, thereby reserving for issuance 2,000,000 shares of common stock in the aggregate. As of September 30, 2018, approximately 0.2 million shares of common stock were reserved for issuance under the Amended 2018 Plan (taking into account all option exercises and other equity award settlements through September 30, 2018).

#### Stock Option Activity

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

	Stock Option Activity			Aggregate Intrinsic Value (in thousands)
	Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	
Balance outstanding at December 31, 2017	7,959	\$ 10.71		
Granted	1,952	15.03		
Exercised	(2,874)	10.72		
Cancelled or expired	(554)	9.91		
Balance outstanding at September 30, 2018	6,483	\$ 12.07	6.91	\$ 90,038
Options vested and expected to vest	5,614	\$ 11.80	6.55	\$ 79,474
Options exercisable at September 30, 2018	3,250	\$ 11.00	4.78	\$ 48,604

The total fair value of stock options exercised during the nine months ended September 30, 2018 was approximately \$15.2 million. As of September 30, 2018, there was approximately \$16.1 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 2.9 years.

The following table summarizes information about outstanding and vested stock options as of September 30, 2018:

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 - \$7.60	1,152	6.47	\$ 6.92	583	\$ 6.43
\$7.95 - \$9.55	664	6.35	9.21	479	9.21
\$9.90 - \$10.13	659	5.72	10.09	655	10.09
\$10.31 - \$11.96	674	7.06	11.27	395	11.01
\$12.09 - \$12.32	41	2.85	12.29	41	12.29
\$12.45 - \$12.45	930	9.38	12.45	—	—
\$12.46 - \$13.59	759	3.76	13.28	702	13.26
\$14.30 - \$15.96	697	8.72	14.72	61	15.94
\$16.05 - \$21.75	721	6.92	18.09	334	17.44
\$22.35 - \$27.25	186	9.82	23.84	—	—
	6,483	6.91	\$ 12.07	3,250	\$ 11.00

#### Restricted Stock Unit Activity

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

	Number of Shares (in thousands)	Average Grant Date Fair Value (Per Share)	Aggregate Fair Value (in thousands)
Balance outstanding at December 31, 2017	1,123	\$ 9.03	\$ —
Awarded	2,130	16.35	—
Released	(334 )	9.04	—
Forfeited	(234 )	10.42	—
Non-vested and outstanding at September 30, 2018	2,685	\$ 14.71	\$ 69,673
Expected to vest	1,878	\$ 13.93	\$ 48,741

RSUs granted to employees generally vest over a three to four-year period or upon achievement of certain performance conditions. In accordance with ASU 2017-09, as of September 30, 2018, total unrecognized compensation cost, adjusted for estimated forfeitures, related to nonvested RSUs was approximately \$35.9 million and the weighted-average remaining vesting period was 2.8 years.

#### 12. Restructuring

The Company's restructuring costs relate to the wind-down of our legacy platform and severance costs associated with re-prioritizing and reallocating resources to focus on areas showing high growth potential within our Business Segment. The expense associated with this restructuring was approximately \$0.7 million during the three months ended September 30, 2018 and approximately \$2.8 million and \$2.3 million during the nine months ended September 30, 2018 and 2017, respectively. There were no restructuring costs during the three months ended

September 30, 2017. The Company expects to incur additional restructuring costs through December 31, 2019. The restructuring liability was approximately \$1.2 million as of September 30, 2018 and \$2.3 million as of December 31, 2017. It is classified as accrued expenses and other current liabilities on the condensed consolidated balance sheets.

The following table presents the detail of the liability for the Company's restructuring charges for the periods presented (amounts in thousands):

	September 30, 2018	December 31, 2017
Balance, Beginning of the year	\$ 2,338	\$ 2,551
Severance and other associated costs	2,806	648
Cash payments	(3,895 )	(2,807 )
Wind down cost legacy platform	—	1,946
Balance, End of period	\$ 1,249	\$ 2,338

The following table presents the detail of expenses for the Company's restructuring charges for the three months ended September 30, 2018 (amounts in thousands):

	September 30, 2018	September 30, 2017
Severance and other associated costs	\$ 722	\$ (31 )
Wind down cost legacy platform	—	31
Total restructuring costs	\$ 722	\$ —

The following table presents the detail of expenses for the Company's restructuring charges for the nine months ended September 30, 2018 (amounts in thousands):

	September 30, 2018	September 30, 2017
Severance and other associated costs	\$ 2,806	\$ 399
Wind down cost legacy platform	—	1,916
Total restructuring costs	\$ 2,806	\$ 2,315

### 13. Legal Matters

The Company previously 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. 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 March 16, 2017, the New York case was voluntarily transferred and consolidated with the two California cases in the Northern District of California for all pre-trial purposes. Recent rulings by both the Court and the United States Patent Office in the Company's favor have invalidated the majority of [24]7 patents that were asserted in the patent cases. Trial for the Company's intellectual property and other claims asserted against [24]7 in the original litigation is currently set for April 1, 2019. The Company believes the claims filed by [24]7 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.

#### 14. Subsequent Events

##### AdvantageTec Inc.

In October 2018, the Company entered into a stock purchase agreement to acquire the outstanding equity interest of AdvantageTec, Inc. (“AdvantageTec”), a leading provider of texting solutions for service departments of automotive dealerships that helps enable conversational commerce across the entire dealership, including variable and fixed operations. The purchase agreement was for total consideration of approximately \$16.6 million, which includes approximately \$6.0 million in cash, approximately \$4.5 million in shares of common stock and approximately \$5.7 million of potential earn-out consideration in cash and shares of common stock. The earn-out is contingent upon achieving certain targeted financial, strategic and integration objectives and milestones and is included as part of the purchase price. The acquisition enhances the Company’s messaging platform available for the automotive industry. The transaction will be accounted for under the purchase method of accounting. The Company is in the process of finalizing all fair value and purchase accounting adjustments.



## 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 is 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 our service was introduced in November 1998. We make life easier by transforming how people communicate with brands. LiveEngage, our enterprise-class, cloud-based platform, enables businesses and consumers to connect through conversational interfaces, such as in-app and mobile messaging, while leveraging bots and Artificial Intelligence (AI) to increase efficiency. As consumers have reoriented their digital lives around the smartphone, messaging apps have become their preferred communication channel to connect with each other. We allow brands to align with this new consumer preference, and deploy messaging at scale for customer care, marketing and sales, instead of requiring that consumers use email or call a 1-800 number. More than 18,000 businesses, including Adobe, Citibank, EE, HSBC, IBM, L'Oreal, Orange, PNC, and The Home Depot employ our technology to keep pace with rising customer service expectations and to align with preferences for digital communication channels.

We are organized into two operating segments: Business and Consumer. The Business segment enables brands to leverage LiveEngage's sophisticated intelligence engine to connect with consumers through an integrated suite of mobile and online business messaging technologies. 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 a leading provider of online and mobile messaging solutions that transform how people communicate with brands. To accomplish this, we are focused on the following current initiatives:

**Strengthening Our Position in both Existing and New Markets and Growing Our Recurring Revenue Base.**

LivePerson plans to continue to develop its market position by increasing its customer base, and expanding within its installed base. We will continue to focus primarily on key target markets: automotive, financial services, retail, technology, telecommunications, and travel/hospitality within both our enterprise and mid-market sectors, as well as the small business (SMB) sector. Healthcare, insurance, real estate and energy utilities are new target industries and natural extensions of our primary target markets. We plan to leverage our LiveEngage platform to replace a portion of calls traditionally made to 1-800 numbers with text and mobile messaging, and to increase adoption of real-time, campaign-based messaging across our customer's online properties. We intend to collaborate with our large installed customer base to optimize the value and effectiveness that brands derive from our services. We are also focused on strengthening our recurring revenue stream by signing larger, long-term, and more strategic deals.

One of the key ways we are developing our market position is by hosting customer summits for executive level attendees from our targeted enterprise customer base and prospects. These customer summits feature existing customers that have demonstrated strong success with messaging and bots on LiveEngage. We believe that scaled reference customers advocating the adoption of messaging on LiveEngage to targeted peer groups will be a key driver of our growth. In 2017, we increased the pacing and scale of these summits, a pattern that we have continued in 2018.

Fuel Increased Usage by Expanding Messaging Channels, Use Cases and Interaction Types. LiveEngage currently supports numerous messaging endpoints including branded mobile apps, mobile and desktop web browsers, IVRs, SMS, Facebook Messenger and LINE. We intend to increase the number of endpoints supported by the LiveEngage platform to include additional third-party social apps and device-based systems. We also intend to broaden the use cases of LiveEngage across our customer base, to support care, sales, marketing and retail footprints. In addition, LivePerson continues to expand the breadth of interaction types available to customers on the platform. For example, in addition to our broad suite of messaging and real-time chat

technologies, customers have access to content delivery, analytics, cobrowse, and PCI compliance, as well as proprietary and third-party bot offerings. LivePerson offers a platform pricing model, which provides businesses access to our entire suite of messaging technologies across their entire agent pool for a pre-negotiated cost per interaction. We believe this model will lead to growth opportunities for LivePerson as customers adopt new messaging channels, use cases and interaction types.

**Leverage Partners to Enhance our Offering.** In addition to developing our own applications, we continue to cultivate a partner ecosystem capable of offering additional applications and services to our customers. The pace of our ecosystem expansion has accelerated in 2018, as we built on our existing integrations with Facebook Messenger and LINE, by adding integrations to Apple Business Chat, Google Rich Business Messenger, WhatsApp, Alexa and Google Home. These popular conversational interfaces enable brands the opportunity to connect to millions of consumers, which in turn can increase traffic on our platform.

Our offering is vendor agnostic, empowering our customers to manage a mix of different bots, human agents and technologies from one control panel, thereby optimizing contact center efficiency. In 2017, LivePerson launched the LiveEngage for Bots program and we have subsequently integrated LiveEngage with multiple artificial intelligence/bots vendors, including IBM Watson. LivePerson's proprietary and third-party AI/bots enable brands to partially or fully automate communications with their customers. 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. In 2017, we allocated additional resources to supporting partners and we expect this investment to increase as our partner network expands.

**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. In order to better support our customers and to attract the best talent, LivePerson is globalizing research and development. We now have tech centers in Israel; Mannheim, Germany; New York; Atlanta; Austin; San Francisco; and Seattle. 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.

**International Presence.** LivePerson is focused on expanding its international revenue contribution, which increased to 37% of total revenue in 2017, from 34% in 2016 and 33% in 2015. LivePerson generated positive results from previous investments in direct sales and services personnel in the United Kingdom and Western Europe. We also continued to focus on expanding our presence in the Asia Pacific region, leveraging our relationships with partners.

**Continuing to Build Brand Recognition.** As a pioneer of brand-to-consumer digital messaging, LivePerson enjoys strong brand recognition and credibility. We continue to develop relationships with the media, industry analysts and relevant business associations to enhance awareness of our leadership within the care, sales, tech and marketing industries. With a vision of becoming the leader in messaging, we've hosted several private executive events for our customers and prospects, highlighting our expertise and the breadth of our services. These private executive events have led us to close several high-profile deals and we are continuing them throughout 2018. Our focus on connecting large enterprise businesses and their millions of consumers securely and at scale is a primary differentiator for LivePerson and a key component of our marketing strategy. We strategically target decision makers and influencers within several key vertical markets, leveraging customer successes to generate increased awareness and demand for brand-to-consumer messaging. In addition, our brand name may also be visible to both business users and consumers on a brand's website, within the dialog messaging window. We also engage in digital marketing campaigns that promote our brand on web searches and third-party sites.

**Increasing the Value of Our Service to Our Customers.** Leveraging LiveEngage to shift communication between consumers and brands from 1-800 number calls to AI and human-powered messaging is the most important initiative in LivePerson's history. We believe that adoption of LiveEngage will align brands with consumer communication preferences, improve the customer experience and reduce contact center costs. Our platform strategy makes available

the full suite of LivePerson's capabilities through a single solution. In addition, the open architecture of LiveEngage will enable LivePerson to rapidly add new capabilities either directly or through partners. For example, we see opportunities for additional efficiencies in the contact center through the integration of artificial intelligence and bots. 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. Our strategy is to continue to enhance the LiveEngage messaging platform and to leverage the substantial amount of mobile and online consumer data we collect, with the aim of increasing agent efficiency, decreasing customer care costs, improving the customer experience and increasing customer lifetime value.

**Evaluating Strategic Alliances and Acquisitions When Appropriate.** We have successfully integrated several acquisitions over the past decade. While we have in the past, and may from time to time in the future, engage in discussions regarding 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, 2018 compared to the three months ended September 30, 2017:

Total revenue increased 14% to \$64.2 million from \$56.5 million

Revenue from our Business segment increased 14% to \$59.3 million from \$52.1 million.

Gross profit margin increased to 76% from 74%.

Cost and expenses increased 22% to \$69.0 million from \$56.7 million.

Net loss increased to \$7.0 million from \$1.3 million.

Average annual revenue per enterprise and mid-market customer was greater than \$270,000 over the trailing twelve months ended September 30, 2018, as compared to greater than \$215,000 for the trailing twelve months ended September 30, 2017.

The revenue retention rate for full service customers on LiveEngage was greater than 100% over the trailing twelve months ended September 30, 2018, continuing the trend of 100% plus revenue retention that we reported in 2017. Revenue retention rate measures the percentage of revenue retained at quarter end, from full service customers that were on LiveEngage at the same period a year ago.

## Adjusted EBITDA

To provide investors with additional information regarding our financial results, we have disclosed adjusted EBITDA, which is a non-GAAP financial measure. The adjusted EBITDA table below presents a reconciliation of adjusted EBITDA to net loss, the most directly comparable GAAP financial measure.

We have included adjusted EBITDA in this Quarterly Report on Form 10-Q because it is a key measure 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 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 provides 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 impact of restructuring cost;

adjusted EBITDA does not consider the 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 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		Nine Months Ended		
	September 30,		September 30,		
	2018	2017	2018	2017	
Reconciliation of Adjusted EBITDA					
GAAP net loss	\$(7,043)	\$(1,310)	\$(18,567)	\$(14,519)	
Amortization of purchased intangibles	709	1,109	2,131	3,968	
Stock-based compensation	4,074	1,843	10,338	6,103	
Depreciation	3,557	3,179	10,343	9,017	
Other non-recurring costs	1,608	(1) 1,640	(2) 4,646	(3) 4,998	(2)
Restructuring costs	722	(4) —	2,806	(5) 2,315	(6)
Provision for income taxes	2,004	1,256	2,051	3,000	
Other expense (income), net	213	(191 )	53	(412 )	
Adjusted EBITDA	\$5,844	\$7,526	\$13,801	\$14,470	

(1) Includes litigation costs of \$1.1 million and consulting costs of \$0.5 million for the three months ended September 30, 2018.

(2) Includes litigation costs of \$1.6 million and \$5.0 million for the three and nine months ended September 30, 2017, respectively.

(3) Includes litigation costs of \$3.2 million, consulting costs of \$0.9 million, executive recruitment costs of \$0.3 million, and executive relocation costs of \$0.2 million for the nine months ended September 30, 2018.

(4) Includes severance costs of \$0.1 million and other compensation-related costs of \$0.6 million for the three months ended September 30, 2018.

(5) Includes severance costs of \$2.2 million and other compensation-related costs of \$0.6 million for the nine months ended September 30, 2018.

(6) Includes wind down costs of legacy platform of \$1.9 million and severance costs of \$0.4 million for the nine months ended September 30, 2017.

#### 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. Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract;
- determination of the transaction price;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, the Company satisfies a performance obligation.

Total revenue of \$64.2 million and \$184.1 million recognized during the three months and nine months ended September 30, 2018, respectively, under ASU No. 2014-09, "Revenue from Contracts with Customers" ("Topic 606"), was not materially different from what would have been recognized under Topic 605.