SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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 JUNE 30, 2002

or

o 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: 0-30141

LIVEPERSON, INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE (State or Other Jurisdiction of Incorporation or Organization)	**13-3861628** (IRS Employer Identification No.)
462 SEVENTH AVENUE, 21ST FLOOR **NEW YORK, NEW YORK** (Address of Principal Executive Offices)	**10018** (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 o

As of August 9, 2002, there were 34,020,881 shares of the issuer's common stock outstanding.

LIVEPERSON, INC.
JUNE 30, 2002
FORM 10-Q
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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

LIVEPERSON, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	June 30, 2002 (Unaudited)	December 31, 2001 (Note 1(B))
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,426	$ 10,136
Accounts receivable, net of allowances for doubtful accounts of $160 and $160 as of June 30, 2002 and December 31, 2001, respectively	245	620
Prepaid expenses and other current assets	509	389
Total current assets	11,180	11,145
Property and equipment, net	763	915
Goodwill and other intangibles, net	—	5,338
Security deposits	119	122
Other assets	148	107
Total assets	$ 12,210	$ 17,627
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 672	$ 592
Accrued expenses	1,879	2,115
Deferred revenue	527	560
Total current liabilities	3,078	3,267
Other liabilities	129	89
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.001 par value per share; 5,000,000 shares authorized, 0 shares issued and outstanding at June 30, 2002 and December 31, 2001	—	—
Common stock, $.001 par value per share; 100,000,000 shares authorized, 34,018,381 shares issued and outstanding at June 30, 2002, 33,983,381 shares issued and outstanding at December 31, 2001	34	34
Additional paid-in capital	113,049	113,071
Deferred compensation	(147)	(399)
Accumulated deficit	(103,925)	(98,428)
Accumulated other comprehensive loss	(8)	(7)
Total stockholders' equity	9,003	14,271
Total liabilities and stockholders' equity	$ 12,210	$ 17,627

SEE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

LIVEPERSON, INC.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Revenue	$ 1,873	$ 1,915	$ 3,699	$ 4,283
Operating expenses:				
Cost of revenue, exclusive of $(6) and $(232) for the three months ended June	318	2,144	656	4,826

30, 2002 and 2001, respectively, and $(4) and $(195) for the six months ended June 30, 2002 and 2001, respectively, reported below as non-cash compensation (credit)				
Product development expense, exclusive of $0 and $(3) for the three months ended June 30, 2002 and 2001, respectively, and $0 and $(182) for the six months ended June 30, 2002 and 2001, respectively, reported below as non-cash compensation expense (credit)	281	883	577	2,135
Sales and marketing expense, exclusive of $42 and $64 for the three months ended June 30, 2002 and 2001, respectively, and $64 and $324 for the six months ended June 30, 2002 and 2001, respectively, reported below as non-cash compensation expense	493	1,178	1,057	3,294
General and administrative expense, exclusive of $80 and $(161) for the three months ended June 30, 2002 and 2001, respectively, and $158 and $96 for the six months ended June 30, 2002 and 2001, respectively, reported below as non-cash compensation expense (credit)	750	1,626	1,421	3,568
Amortization of goodwill	—	743	—	1,485
Non-cash compensation expense (credit), net	116	(332)	218	43
Non-cash compensation credit related to restructuring, net	—	—	—	(1,720)
Restructuring and impairment charges	—	117	—	3,508
Total operating expenses	1,958	6,359	3,929	17,139
Loss from operations	(85)	(4,444)	(230)	(12,856)
Other income (expense):				
Other, net	—	61	—	66
Interest income	34	124	71	359
Interest expense	—	—	—	(7)
Total other income, net	34	185	71	418
Loss before cumulative effect of accounting change	(51)	(4,259)	(159)	(12,438)
Cumulative effect of accounting change	—	—	(5,338)	—
Net loss	$ (51)	$ (4,259)	$ (5,497)	$ (12,438)
Basic and diluted net loss per share:				
Loss before cumulative effect of accounting change	$ (0.00)	$ (0.13)	$ (0.00)	$ (0.37)
Cumulative effect of accounting change	0.00	0.00	(0.16)	0.00
Net loss	$ (0.00)	$ (0.13)	$ (0.16)	$ (0.37)
Weighted average shares outstanding used in basic and diluted net loss per share calculation	34,029,588	33,992,277	34,016,671	33,972,180

SEE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

LIVEPERSON, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS) UNAUDITED

	Six Months Ended June 30,	
	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (5,497)	$ (12,438)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Cumulative effect of accounting change	5,338	—
Non-cash compensation expense, net	218	43
Non-cash compensation credit related to restructuring, net	—	(1,720)
Non-cash portions of restructuring and impairment charges	—	855
Depreciation	181	1,642
Amortization of goodwill	—	1,485
Amortization of gain on sale-leaseback	—	(131)
Provision for doubtful accounts, net	—	601
CHANGES IN OPERATING ASSETS AND LIABILITIES:		
Accounts receivable	374	(177)
Prepaid expenses and other current assets	(119)	134
Security deposits	3	29
Accounts payable	80	(377)
Accrued expenses	(237)	1,533
Deferred revenue	(33)	(350)
Deferred rent	—	49
Net cash provided by (used in) operating activities	308	(8,822)
CASH FLOWS FROM INVESTING ACTIVITIES:		

Purchases of property and equipment, including capitalized software	(42)	(492)
Proceeds from sale of property and equipment	13	45
Proceeds from sale of investment securities available-for-sale	—	1,000
Purchase of restricted cash related to lease	—	(2,225)
Additional cash paid for HumanClick acquisition	—	(22)
Net cash used in investing activities	(29)	(1,694)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock in connection with the exercise of options	12	38
Proceeds from issuance of common stock in connection with Employee Stock Purchase Plan	—	2
Net cash provided by financing activities	12	40
Effect of foreign exchange rate changes on cash and cash equivalents	(1)	(6)
Net increase (decrease) in cash and cash equivalents	290	(10,482)
Cash and cash equivalents at the beginning of the period	10,136	20,449
Cash and cash equivalents at the end of the period	$ 10,426	$ 9,967

SEE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

LIVEPERSON, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

(1) SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

(A) SUMMARY OF OPERATIONS

LivePerson, Inc. (the “Company” or “LivePerson”) was incorporated in the State of Delaware in 1995. The Company commenced operations in 1996. The Company is an application service provider of technology that facilitates real-time sales and customer service for companies doing business on the Internet.

The Company’s primary revenue source is from the sale of the LivePerson services, which is conducted within one operating segment. The Company’s product development staff, help desk and online sales support are located in Israel.

(B) UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The accompanying interim condensed consolidated financial statements as of June 30, 2002 and for the three and six months ended June 30, 2002 and 2001 are unaudited. In the opinion of management, the unaudited interim 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 June 30, 2002, and the consolidated results of operations and cash flows for the interim periods ended June 30, 2002 and 2001. 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, 2001 has been derived from audited consolidated financial statements at that date.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto for the year ended December 31, 2001, included in the Company’s Form 10-K filed with the SEC on April 1, 2002.

(C) REVENUE RECOGNITION

The LivePerson services facilitate real-time sales and customer service for companies doing business on the Internet. The Company charges a monthly fee for using the LivePerson services based on usage. Certain of the Company’s larger clients, who require more sophisticated implementation and training, also pay an initial non-refundable set-up fee.

The initial set-up fee principally represents customer service, training and other administrative costs related to the deployment of the LivePerson services. Such fees are initially recorded as deferred revenue and recognized ratably over a period of 24 months, representing the Company’s current estimate of the expected term of a client relationship. This estimate may change in the future. The Company typically does not charge an additional set-up fee if an existing client adds more services. Unamortized deferred fees, if any, are recognized upon termination of the agreement with the customer. The Company recognized $3 and $10 in the three and six months ended June 30, 2002, and $0 and $0 in the three and six months ended June 30, 2001, of set-up fees due to client attrition.

In the first half of 2001, the Company began selling the LivePerson services directly via Internet download. These services are paid for almost exclusively by credit card. Credit card payments accelerate cash flow and reduce the Company's collection risk, subject to the merchant bank's right to hold back cash pending settlement of the transactions. Sales executed via Internet download may occur with or without the assistance of an online sales representative, rather than through face-to-face or telephone contact that is typically required for traditional direct sales. Sales of the LivePerson services via Internet download typically have no set-up fee, because the Company does not provide the customer with training and administrative costs are minimal. The Company records revenue for its traditional direct sales and Internet download sales based upon a monthly fee charged for the LivePerson services, provided that no significant Company obligations remain and collection of the resulting receivable is probable. The Company recognizes monthly service revenue fees as services are provided. The Company's service agreements typically have no termination date and are terminable by either party upon 30 to 90 days' notice without penalty.

The Company also generates revenue from commissions paid to the Company by Web hosting and call center companies for revenue generated by them as a result of referrals by the Company. The Company recognizes commissions based on revenue generated from these referrals upon notification from the other party of sales attributable to LivePerson. To date, revenue from such commissions has not been material. Professional services revenue consists of training provided to customers. Revenue is recognized when services are provided and collection of the resulting receivable is probable. To date, revenue from professional services has not been material.

(D) BASIC AND DILUTED NET LOSS PER SHARE

The Company calculates earnings per share in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share ("EPS")," and the SEC Staff Accounting Bulletin No. 98. Under SFAS No. 128, 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 share calculation of basic and diluted net loss. In October 2000, the Company acquired HumanClick Ltd., a private company organized under the laws of Israel ("HumanClick"). Since that time, the Company has included 20,229 shares of common stock in the share calculation of basic and diluted net loss which relate to certain options that were originally issued by HumanClick for nominal consideration and subsequently assumed by the Company in connection with its acquisition of HumanClick. Diluted EPS 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 share presented is equal to basic net loss per share since all common stock equivalents are anti-dilutive for each of the periods presented.

Diluted net loss per common share for both of the three and six month periods ending June 30, 2002 and 2001, respectively, does not include the effects of options to purchase 5,979,255 and 6,478,170 shares of common stock, respectively, warrants to purchase 457,030 and 457,030 shares of common stock, respectively, and an aggregate of 0 and 0 shares of convertible preferred stock on an "as if" converted basis, respectively, as the effect of their inclusion is anti-dilutive during each period.

(E) RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes both SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS No. 121. For example, SFAS No. 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. SFAS No. 144 retains the basic provisions of APB Opinion No. 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike SFAS No. 121, an impairment assessment under SFAS No. 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under SFAS No. 142, "Goodwill and Other Intangible Assets."

The Company adopted SFAS No. 144 on January 1, 2002. The adoption of SFAS No. 144 for long-lived assets held for use did not have a material impact on the Company's financial statements because the impairment assessment under SFAS No. 144 is largely unchanged from SFAS No. 121. The provisions of the Statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities. Therefore, management cannot determine the potential effects that adoption of SFAS No. 144 will have on the Company's financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of SFAS Nos. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections." SFAS No. 4 required all gains and losses from the extinguishment of debt to be reported as extraordinary items and SFAS No. 64 related to the same matter. SFAS No. 145 requires gains and losses from certain debt extinguishment not to be reported as extraordinary items when the use of debt extinguishment is part of the risk management strategy. SFAS No. 44 was issued to establish transitional requirements for motor carriers. Those transitions are completed, therefore SFAS No. 145 rescinds SFAS No. 44. SFAS No. 145 also amends SFAS No. 13 requiring sale-leaseback accounting for certain lease modifications. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. The provisions relating to sale-leaseback are effective for transactions after May 15, 2002. The adoption of SFAS No. 145 is not expected to have a material impact on the Company's financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The principal difference between SFAS No. 146 and EITF 94-3 relates to the timing of liability recognition. Under SFAS No. 146, a liability for a cost associated with an exit or disposal activity is recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS No. 146 is not expected to have a material impact on the Company's financial position or results of operations.

(2) BALANCE SHEET COMPONENTS

Property and equipment is summarized as follows:

	June 30, 2002	December 31, 2001

		(Unaudited)	
Computer equipment and software	$	1,385	$ 1,364
Furniture, equipment and building improvements		76	68
		1,461	1,432
Less accumulated depreciation		698	517
Total	$	763	$ 915

Accrued expenses consist of the following:

	June 30, 2002 (Unaudited)	December 31, 2001
Professional services and consulting fees	$ 311	$ 531
Payroll and related costs	430	348
Sales commissions	5	71
Restructuring charges (see note 4)	981	1,040
Other	152	125
Total	$ 1,879	$ 2,115

(3) CUMULATIVE EFFECT OF ACCOUNTING CHANGE

On January 1, 2002, the Company was required to adopt the full provisions of SFAS No. 142, “Goodwill and Other Intangible Assets.” SFAS No. 142 requires that goodwill and certain indefinite-lived intangibles no longer be amortized, but instead be tested for impairment at least annually. This testing requires the identification of reporting units and comparison of the reporting units' carrying value to their fair value and, when appropriate, requires the reduction of the carrying value of impaired assets to their fair value.

The transitional impairment analysis required upon adoption of SFAS No. 142 was completed during the first quarter of 2002, and the Company determined that there was an impairment of the carrying value of goodwill. As part of this analysis, management determined that the Company continued to operate in one operating segment and that it does not have any separate reporting units under SFAS No. 142; accordingly, the impairment analysis was performed on an enterprise-wide basis. This process included obtaining an independent appraisal of the fair value of the Company as a whole and of its individual assets. Fair value was determined from the same cash flow forecasts used in December 2001 for the evaluation of Company’s carrying value under SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,” which was the accounting rule for impairment of goodwill that preceded SFAS No. 142 and was effective through December 31, 2001. The valuation methodology required by SFAS No. 142 is different than that required by SFAS No. 121. An impairment is more likely to result under SFAS No. 142 because it requires, among other items, the discounting of forecasted cash flows as compared to the undiscounted cash flow valuation method under SFAS No. 121.

The allocation of fair values to identifiable tangible and intangible assets as of January 1, 2002, resulted in an implied valuation of the goodwill of $0. The implied fair value of goodwill was determined in the same manner as determining the amount of goodwill that would have been required to be recognized in a business combination. That is, under SFAS No. 142, an entity is required to allocate the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire it. Comparing this implied value to the carrying value resulted in an impairment of $5,338, with no income tax effect. This impairment is recorded as a cumulative effect of accounting change on the Company’s statement of operations as of January 1, 2002.

As required by SFAS No. 142, the following table shows the Company’s 2001 results, which are presented on a basis comparable to the 2002 results, adjusted to exclude amortization expense related to goodwill:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Loss before cumulative effect of accounting change - as reported	$ (51)	$ (4,259)	$ (159)	$ (12,438)
Add back: Goodwill amortization	—	743	—	1,485
Loss before cumulative effect of accounting change - as adjusted	$ (51)	$ (3,516)	$ (159)	$ (10,953)
Net loss - as reported	$ (51)	$ (4,259)	$ (5,497)	$ (12,438)
Add back: Goodwill amortization, net of tax	—	743	—	1,485
Net loss - as adjusted (1)	$ (51)	$ (3,516)	$ (5,497)	$ (10,953)
Basic and diluted net loss per share:				
Net loss - as reported	$ (0.00)	$ (0.13)	$ (0.00)	$ (0.37)
Add back: Goodwill amortization	—	0.02	—	0.04
Net loss - as adjusted (1)	$ (0.00)	$ (0.11)	$ (0.00)	$ (0.33)

(1) Includes cumulative effect of a change in accounting principle, which increased the net loss by $5,338 and the basic and diluted net loss per share by $0.16 during the six months ended June 30, 2002.

(4) RESTRUCTURING AND IMPAIRMENT CHARGES

In the first quarter of 2001, following a review of the Company's business in connection with its acquisition of HumanClick, the Company commenced restructuring initiatives to streamline its operations, including the consolidation of its two San Francisco Bay area offices. The restructuring resulted in a reduction of the Company's workforce by approximately 90 people as of the end of the first quarter of 2001. In the first quarter of 2001, the Company recorded a charge of $3,391 for severance and other expenses related to the restructuring.

In the third quarter of 2001, in a continued effort to streamline its operations, the Company initiated additional restructuring initiatives. These initiatives resulted in the elimination of redundant staff positions, the consolidation of all clients onto a single application platform and the decision to relocate its principal executive offices, which included the termination of an office space lease. These initiatives resulted in a reduction of the Company's workforce by approximately 20 people, the write-off of impaired computer equipment and software and the write-off of certain furniture, equipment and building improvements.

As a result of the various restructuring initiatives, for the year ended December 31, 2001, the Company recorded restructuring and impairment charges of approximately $12,740, in the aggregate. In addition, for the year ended December 31, 2001, the Company also recognized a net non-cash compensation credit in the amount of approximately $1,720 associated with LivePerson employees who were terminated as part of the Company's restructuring initiatives in the first quarter of 2001. The net non-cash compensation credit of $1,720 for the year ended December 31, 2001 represents the reversal of $3,228 of previously recognized amortization of deferred compensation related to options of employees which did not vest due to their termination of employment in connection with the Company's restructuring initiatives, offset by the acceleration of vesting of certain other employee options of $1,508 also in connection with the restructuring initiatives. Approximately $446 of the $1,508 represents additional compensation related to the intrinsic value of options at the date of modification recorded during the first quarter of 2001. The balance of the accrued restructuring and impairment charges as of June 30, 2002 is as follows:

	Balance as of January 1, 2002	Net utilization during the six months ended June 30, 2002	Balance as of June 30, 2002
Severance	$ 55	$ —	$ 55
Contract terminations	985	(59)	926
Total	$ 1,040	$ (59)	$ 981

(5) STOCK OPTIONS

During 1998, the Company established the Stock Option and Restricted Stock Purchase Plan (the "1998 Plan"). Under the 1998 Plan, the Board of Directors could issue incentive stock options or nonqualified stock options to purchase up to 5,850,000 shares of common stock.

The Company established a successor to the 1998 Plan, the 2000 Stock Incentive Plan (the "2000 Plan"). Under the 2000 Plan, the options which had been outstanding under the 1998 Plan were incorporated into the 2000 Plan and the Company increased the number of shares available for issuance under the plan by approximately 4,150,000, thereby reserving for issuance 10,000,000 shares of common stock in the aggregate. Options to acquire common stock granted thereunder have ten-year terms. Pursuant to the provisions of the 2000 Plan, the number of shares of common stock available for issuance thereunder automatically increases on the first trading day in each calendar year by an amount equal to three percent (3%) of the total number of shares of the Company's common stock outstanding on the last trading day of the immediately preceding calendar year, but in no event shall such annual increase exceed 1,500,000 shares. As of June 30, 2002, approximately 12,037,000 shares of common stock were reserved for issuance under the 2000 Plan.

In March 2000, the Company adopted the 2000 Employee Stock Purchase Plan with 450,000 shares of common stock initially reserved for issuance. Pursuant to the Employee Stock Purchase Plan, 4,000 and 25,951

shares were issued in 2001 and 2000, respectively. Pursuant to the provisions of the Employee Stock Purchase Plan, the number of shares of common stock available for issuance thereunder automatically increases on the first trading day in each calendar year by an amount equal to one-half of one percent (0.5%) of the total number of shares of the Company's common stock outstanding on the last trading day of the immediately preceding calendar year, but in no event shall such annual increase exceed 150,000 shares. As of June 30, 2002, 750,000 shares of common stock were reserved for issuance under the Employee Stock Purchase Plan. Effective October 2001, the Company suspended the Employee Stock Purchase Plan until further notice.

During May 1999, the Company issued an option to purchase 94,500 shares of common stock at an exercise price of $1.60 per share to a client in connection with an agreement by the Company to provide services to the client for a two-year period. The Company was receiving subscription revenue from the client over the two-year period based on the number of LivePerson Chat operator access accounts the client was using. There was no minimum guarantee. This option originally provided that it would vest in or before May 2001 if the client met certain defined revenue targets and was exercisable for a period of three years from the date of grant. The Company accounted for this option in accordance with EITF Abstract No. 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." Pursuant to EITF No. 96-18, the Company valued the option at each balance sheet date using a Black-Scholes pricing model using a volatility factor of 50%, a $1.60 per share exercise price and the then fair value of the Company's common stock as of each balance sheet date. The $566 value ascribed to the option reflected the market value at December 31, 1999, less amortization expense of $86 for the period from May 1999 through December 1999, which was recorded as net deferred cost on the Company's December 31, 1999 balance sheet. The unamortized value ascribed to this option was adjusted at each balance sheet date to bring the total ascribed value of the option up to the then current unamortized fair value. This cost was ratably amortized over the two-year service agreement, as the Company believed that the achievement of the revenue targets was probable. As a result, the Company amortized $86 of the deferred costs as of December 31, 1999, of which $24 was offset against the $27 of revenue recognized from the client in 1999, and the remaining $62 of sales and marketing expense was reflected as a non-cash compensation expense, all of which was recorded in the fourth quarter of 1999.

In February 2000, the Company amended the option agreement with the client whereby the option became fully vested and immediately exercisable. The client exercised the option in May 2000. However, the client was precluded from selling the underlying common stock until the earlier of five years or, if certain revenue targets were met, May 19, 2001. The value ascribed to the option at the time the option agreement was amended, using a Black-Scholes pricing model, was $1,014, which was ratably amortized over the remaining service period of approximately fifteen months because the vesting of the option did not affect the Company's obligation under the service agreement. In addition, the ratable amortization of the remaining deferred cost of $1,014 was recorded as a reduction of the revenue recognized from the client, with any excess amortization recorded as sales and marketing expense which was reflected as a non-cash compensation expense in the Company's statement of operations. The Company amortized $723 of the deferred costs during the year ended

December 31, 2000, of which $59 was offset against the $59 of revenue recognized from the client. The remaining $664 of sales and marketing expense was included in non-cash compensation expense in the Company's 2000 statement of operations.

As of March 31, 2001, the Company determined that it was unlikely that the client would meet the remaining revenue requirements under the agreement. Accordingly, the Company has amortized the remaining deferred cost of $291 during the three months ended March 31, 2001, of which $54 was offset against the $54 of revenue recognized from the client. The remaining $237 of sales and marketing expense was included in non-cash compensation expense in the Company's statement of operations for the quarter ended March 31, 2001.

During 2000 and 1999, the Company granted or assumed stock options to purchase 5,730,727 and 3,496,245 shares of common stock at a weighted average exercise price of $3.62 and $1.37, per share, respectively, certain of which were granted at less than the deemed fair value of the common stock at the date of grant. For the years ended December 31, 2000 and 1999, the Company recorded deferred compensation of $18,241 and $6,233, respectively, in connection with the options granted at below the deemed fair value. The aggregate amount of unamortized deferred compensation related to the grant of options which was subsequently reversed against paid-in capital in connection with the forfeiture of those options granted at below the deemed fair value, and associated with employees who left the Company during the year ended December 31, 2000, was approximately $5,370. In 2000, the Company also recorded $272 of deferred compensation relating to the intrinsic value of unvested options

assumed by the Company in connection with the HumanClick acquisition. These amounts are presented as deferred compensation within the consolidated financial statements and are being amortized over the vesting period, typically three to four years, of the applicable options. The Company amortized $11,915 and $1,589 for the years ended December 31, 2000 and 1999, respectively, net of forfeitures or cancellations of $2,023 in connection with employees who left the Company in 2000.

The net non-cash compensation amounts for the three and six months ended June 30, 2002 and 2001 consist of:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
May 1999 option granted to a client (discussed above)	$ —	$ —	$ —	$ 237
Amortization	104	470	206	608
Acceleration of deferred compensation charges related to certain employee terminations	24	206	24	206
Reversal of previously amortized deferred compensation charges due to forfeitures of employee stock options	(12)	(1,008)	(12)	(1,008)
	$ 116	$ (332)	$ 218	$ 43

The net non-cash compensation amounts for the six months ended June 30, 2001 exclude the net non-cash compensation credit of $1,720 related to the Company's restructuring initiatives in the first quarter of 2001, discussed in note 4 above.

The aggregate amount of unamortized deferred compensation reversed against additional paid-in capital was approximately $34 and $34 for the three and six months ended June 30, 2002, and $0 and $2,609 for the three and six months ended June 30, 2001. This amount represents the forfeiture of options associated with the Company's employees whose employment was terminated as part of the Company's restructuring initiatives during the first quarter of 2001, discussed in note 4 above.

(6) COMMITMENTS AND CONTINGENCIES

The Company leases facilities and certain equipment under agreements accounted for as operating leases. These leases generally require the Company to pay all executory costs such as maintenance and insurance. Rental expense for operating leases was approximately $90 and $180 for the three and six months ended June 30, 2002, and $895 and $2,068 for the three and six months ended June 30, 2001.

(7) LEGAL PROCEEDINGS

On December 12, 2001, Compaq Financial Services Corporation, a subsidiary of Compaq Computer Corporation, filed a complaint against the Company in the Supreme Court of the State of New York in New York County. The complaint alleges that the Company is in default of an operating lease for computer equipment. Compaq is seeking to recover approximately $2,000 in damages, fees and expenses. The Company has served an answer asserting affirmative defenses and counterclaims for fraud and negligent misrepresentation, and seeks damages and fees. Compaq has moved for summary judgment on its claims, and the Company has filed papers in opposition to the motion. The motion is currently pending.

On November 16, 2001, Corio, Inc. filed a demand for arbitration against the Company with the American Arbitration Association in San Francisco County, California. The demand is related to a hosted software service contract terminated during 2001. Corio is seeking to recover approximately $1,400 in damages, fees and expenses. The Company has filed an answer denying liability and asserting counterclaims for breach of contract and fraud, and seeks a refund of all amounts paid to Corio, which equal approximately $1,500.

Although the Company intends to defend vigorously each of the matters described above, and believes that the Company has provided adequate reserves in connection with each of the claims, the Company cannot assure you that the Company's defense in either case will be successful and, if it is not, that the Company's ultimate liability in connection with either or both of these claims will not exceed the Company's reserves or have a material adverse effect on the Company's business, results of operations, financial condition, or cash flows.

(8) SUBSEQUENT EVENT

In July 2002, the Company acquired certain assets of NewChannel, Inc. ("NewChannel"). The transaction transferred all existing customer contracts of NewChannel to the Company. The purchase price is based on future revenue generated by the Company from the former NewChannel client base. To date, the Company has incurred total transaction costs of approximately $750, including the initial purchase price payment of $600 to NewChannel. The Company expects the total cost of the transaction to be less than $1,000. The total acquisition cost will be amortized ratably over a period of 18 months, representing the Company's current estimate of the expected term of the client relationships.

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

YOU SHOULD READ THE FOLLOWING DISCUSSION AND ANALYSIS OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS IN CONJUNCTION WITH OUR UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES INCLUDED ELSEWHERE IN THIS REPORT. STATEMENTS IN THE FOLLOWING DISCUSSION ABOUT 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 PROGRESS, AND THEREFORE IT SHOULD BE CLEARLY UNDERSTOOD THAT THE INTERNAL PROJECTIONS AND BELIEFS UPON WHICH WE BASE OUR EXPECTATIONS MAY CHANGE PRIOR TO THE END OF EACH QUARTER OR THE YEAR. ALTHOUGH THESE EXPECTATIONS MAY CHANGE, WE ARE UNDER NO OBLIGATION TO INFORM YOU IF THEY DO. OUR COMPANY POLICY IS GENERALLY TO PROVIDE OUR EXPECTATIONS ONLY ONCE PER QUARTER, AND NOT TO UPDATE THAT INFORMATION UNTIL THE NEXT QUARTER. ACTUAL EVENTS OR RESULTS MAY DIFFER MATERIALLY FROM THOSE CONTAINED IN THE PROJECTIONS OR FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE THOSE DISCUSSED BELOW AND ELSEWHERE IN THIS REPORT, PARTICULARLY IN THE SECTION CAPTIONED "—RISK FACTORS THAT MAY AFFECT FUTURE RESULTS."

CRITICAL ACCOUNTING POLICIES

GENERAL

Our discussion and analysis of our financial condition and results of operations are based upon our unaudited interim 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 and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments that may not be readily apparent from other sources. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions relate to estimates of collectibility of accounts receivable, the realization of goodwill, the expected term of a client relationship, accruals and other factors. We evaluate these estimates on an ongoing basis. Actual results could differ from those estimates under different assumptions or conditions, and any differences could be material.

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 LivePerson services facilitate real-time sales and customer service for companies doing business on the Internet. We charge a monthly fee for our services based on usage. Certain of our larger clients, who require more sophisticated implementation and training, also pay an initial non-refundable set-up fee.

The initial set-up fee is intended to recover certain costs (principally customer service, training and other administrative costs) prior to the deployment of our services. Such fees are recorded as deferred revenue and recognized ratably over a period of 24 months, representing the estimated term of a client relationship. Although we

believe this estimate is reasonable, this estimate may change in the future. In instances where we do charge a set-up fee, we typically do not charge an additional set-up fee if an existing client adds more services. Unamortized deferred fees, if any, are recognized upon termination of the agreement with the customer. We recognized $3,000 and $10,000 in the three and six months ended June 30, 2002, respectively, of set-up fees due to client attrition.

In the first half of 2001, we began selling the LivePerson services directly via Internet download. These services are paid for almost exclusively by credit card. Credit card payments accelerate cash flow and reduce our collection risk, subject to the merchant bank's right to hold back cash pending settlement of the transactions. Sales executed via Internet download may occur with or without the assistance of an online sales representative, rather than through face-to-face or telephone contact that is typically required for traditional direct sales. Sales of the LivePerson services via Internet download typically have no set-up fee, because we do not provide the customer with training and administrative costs are minimal.

We record revenue for traditional direct sales and Internet download sales based upon a monthly fee charged for the LivePerson services, provided that no significant Company obligations remain and collection of the resulting receivable is probable. We recognize monthly service revenue fees as services are provided. Our service agreements typically have no termination date and are terminable by either party upon 30 to 90 days' notice without penalty.

ACCOUNTS RECEIVABLE

Our customers are primarily concentrated in the United States. We perform ongoing credit evaluations of our customers' financial condition (except for customers who purchase the LivePerson services via Internet download, which are paid for almost exclusively by credit card) and have established an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information that we believe to be reasonable, although they may change in the future. Our concentration of credit risk is limited due to the large number of customers. No single customer accounted for or exceeded 10% of our total revenue in the three months ended June 30, 2002 and 2001, or 10% of our total accounts receivable at June 30, 2002 and 2001.

IMPAIRMENT OF LONG-LIVED ASSETS

Prior to January 1, 2002, we accounted for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 121 requires that long-lived assets, including fixed assets and goodwill, be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If events or changes in circumstances indicate that the carrying amount of an asset to be held and used may not be recoverable, we estimate the undiscounted future cash flows to result from the use of the asset and its ultimate disposition. If the sum of the undiscounted cash flows is less than the carrying value, we recognize an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. The assessment of the recoverability of long-lived assets, including fixed assets and goodwill, will be impacted if estimated future operating cash flows are not achieved.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes both SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business (as previously defined in that Opinion). SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS No. 121. For example, SFAS No. 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. SFAS No. 144 retains the basic provisions of APB Opinion No. 30 on how to

present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike SFAS No. 121, an impairment assessment under SFAS No. 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under SFAS No. 142, "Goodwill and Other Intangible Assets."

We adopted SFAS No. 144 on January 1, 2002. The adoption of SFAS No. 144 for long-lived assets held for use did not have a material impact on our financial statements because the impairment assessment under SFAS No. 144 is largely unchanged from SFAS No. 121. The provisions of the Statement for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities. Therefore, we cannot determine the potential effects that adoption of SFAS No. 144 will have on our financial statements.

RESTRUCTURING ACTIVITIES

Restructuring activities are accounted for in accordance with the guidance provided in the consensus opinion of the Emerging Issues Task Force ("EITF"), in connection with EITF Issue 94-3 ("EITF 94-3"). EITF 94-3 generally requires, with respect to the recognition of severance expenses, management approval of the restructuring plan, the determination of the employees to be terminated and communication of benefit arrangement to employees.

OVERVIEW

LivePerson is an application service provider of technology that facilitates real-time sales and customer service for companies doing business on the Internet. We offer our proprietary real-time interaction technology as outsourced services. We currently generate revenue from the sale of our LivePerson services, which enable our clients to communicate directly with Internet users via text-based chat, and to a lesser extent from related professional services. With the LivePerson chat service, our clients can respond to Internet user inquiries in real-time, and can thereby enhance their Internet users' online shopping experience.

We were incorporated in the State of Delaware in November 1995; however, we did not commence operations until January 1996. We had no significant revenue until 1997, when we began to generate revenue from services primarily related to Web-based community programming and media design. In 1998, we shifted our core business focus to the development of the LivePerson services and phased out our prior programming efforts, which last generated revenue in December 1999. We introduced the LivePerson services in November 1998.

In the first quarter of 2001, following a review of our business in connection with our acquisition of the private Israeli company HumanClick Ltd. in October 2000, we commenced restructuring initiatives to streamline our operations, including the consolidation of our two San Francisco Bay area offices. The restructuring resulted in a reduction of our workforce by approximately 90 people as of the end of the first quarter of 2001. In the first quarter of 2001, we recorded a charge of nearly $4.0 million for severance and other expenses related to the restructuring. In the third quarter of 2001, in a continued effort to streamline our operations, we initiated additional restructuring initiatives. These initiatives resulted in the elimination of redundant staff positions, and the decision to relocate our principal executive offices, which included the termination of an office space lease (and the entering into of a new three-year lease that commenced in November 2001). The restructuring resulted in a reduction of our workforce by approximately 20 people, the write-off of impaired computer equipment and software and the write-off of certain furniture, equipment and building improvements. For the year ended December 31, 2001, we recorded net charges of approximately $12.7 million for our various restructuring initiatives.

In connection with our third quarter 2001 restructuring initiatives, we consolidated all of our clients onto a single software application platform and network. We expect the new platform to provide our customers with a more dependable product while reducing our cost of providing these services. Our network is hosted by a third-party provider of secure server hosting services located in the United States. While the cost of providing our services as a result of these initiatives has decreased, we are dependent on our third-party server hosting provider for redundant network connections, server maintenance and general security. We have not experienced any material product instability or operational consequences since the implementation of these initiatives. We have also consolidated our product development, help desk and online sales personnel in our Israel office. As a result, the political, economic or military conditions affecting Israel could have a material adverse effect on our operations in Israel or our business.

In October 2001, our Board of Directors determined that it would not effect the one-for-fifteen reverse split of our common stock approved by our stockholders at the Special Meeting of Stockholders held on September 11, 2001, due to the fact that on September 27, 2001, Nasdaq informed us that on such date they had implemented a moratorium on the minimum bid price and market value of public float requirements for continued listing on The Nasdaq Stock Market, which requirements were suspended until January 2, 2002.

At our Annual Meeting of Stockholders on May 23, 2002, our stockholders approved separate proposals to amend our Fourth Amended and Restated Certificate of Incorporation to effect, alternatively, one of three different reverse splits of our issued and outstanding shares of common stock, at a ratio of one-for-three, one-for-five and one-for-seven. Pursuant to the authority granted by the proposals, our Board of Directors will have the discretion to decide which reverse split to implement, or not to effect a reverse split at all, at any time on or prior to September 16, 2002. The principal purpose of each of the reverse split proposals is to increase the market price of our common stock above the minimum bid requirement of $1.00 per share required by the Nasdaq National Market and the Nasdaq SmallCap Market.

On May 28, 2002, our common stock commenced trading on the Nasdaq SmallCap Market, following approval by The Nasdaq Stock Market, Inc. of our May 14, 2002 application to transfer the listing of our common stock from the Nasdaq National Market to the Nasdaq SmallCap Market. We determined to apply voluntarily for transfer to the Nasdaq SmallCap Market so as to avoid anticipated Nasdaq National Market delisting proceedings and to take advantage of the Nasdaq SmallCap Market rule which provides an extended grace period for compliance with the $1.00 per share minimum bid requirement. We had received a letter from Nasdaq on February 14, 2002, notifying us that during the preceding 30 consecutive trading days, the bid price of our common stock had closed below the minimum bid price of $1.00 per share as required by the Nasdaq National Market under Nasdaq Marketplace Rule 4450(a)(5). The letter stated that we had until May 15, 2002 to demonstrate compliance with such rule and that, if we were not in compliance by that date, Nasdaq would notify us that our securities would be delisted from the Nasdaq National Market. The letter also stated that we could apply to transfer the listing of our common stock to the Nasdaq SmallCap Market.

Our application to transfer the listing of our common stock to the Nasdaq SmallCap Market stayed Nasdaq National Market delisting proceedings related to non-compliance with the Nasdaq National Market’s $1.00 per share minimum bid price requirement. We have until August 13, 2002 to satisfy the Nasdaq SmallCap Market’s $1.00 per share minimum bid price requirement. After that, we could also be eligible for an additional 180 calendar day grace period provided that at such time we meet the initial listing requirements for the Nasdaq SmallCap Market under Nasdaq Marketplace Rule 4310(c)(2)(A), which requires, generally, an issuer to have (i) stockholders’ equity of $5 million, (ii) a market capitalization of $50 million or (iii) net income of $750,000 (excluding extraordinary or non-recurring items) in the most recently completed fiscal year or in two of the three most recently completed fiscal years. We currently meet all of the initial and continued inclusion criteria for the Nasdaq SmallCap Market except for the minimum bid price requirement.

REVENUE

With respect to the LivePerson services, our clients pay us a monthly fee for our services based on usage. Certain of our larger clients, who require more sophisticated implementation and training, also pay an initial non-refundable set-up fee. Our set-up fee is intended to recover certain costs incurred by us (principally customer service, training and other administrative costs) prior to deployment of our services. Such fees are recorded as deferred revenue and recognized over a period of 24 months, representing the estimated expected term of a client relationship. As a result of recognizing set-up fees in this manner, combined with the fact that a small proportion of our clients are charged a set-up fee, revenue attributable to our monthly service fee for the three and six months ended June 30, 2002 accounted for 99% and 99%, respectively, of total LivePerson services revenue. In addition, because we typically do not charge a set-up fee for sales generated via Internet download, we expect the set-up fee to represent a decreasing percentage of total revenue over time. In instances where we do charge a set-up fee, we typically do not charge an additional set-up fee if an existing client adds more services. Our service agreements typically have no termination date and are terminable by either party upon 30 to 90 days’ notice without penalty. We recognize monthly service revenue fees and professional service fees as services are provided. Professional service fees consist of training provided to customers. Given the time required to schedule training for our clients’ operators and our clients’ resource constraints, we have historically experienced a lag between signing a client contract and

generating revenue from that client. This lag has generally ranged from one day to 30 days. There is no lag for sales generated via Internet download, because our services are immediately available and fully functional upon download. To date, revenue from professional services has not been material.

In the first half of 2001, we began selling the LivePerson services directly via Internet download. These services are paid for almost exclusively by credit card. Credit card payments accelerate cash flow and reduce our collection risk, subject to the merchant bank's right to hold back cash pending settlement of the transactions. Sales executed via Internet download may occur with or without the assistance of an online sales representative, rather than through face-to-face or telephone contact which is typically required for traditional direct sales. Sales of the LivePerson services via Internet download typically have no set-up fee, because we do not provide the customer with training, and administrative costs are minimal. We recognize monthly service revenue fees from Internet downloads as services are provided.

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

OPERATING EXPENSES

Our cost of revenue has principally been associated with the LivePerson services and has consisted of:

- compensation costs relating to employees who provide customer service to our clients;

- compensation costs relating to our network support staff;
- allocated occupancy costs and related overhead; and
- the cost of supporting our infrastructure, including expenses related to leasing space and connectivity for our services, third-party network monitoring and depreciation of certain hardware and software.

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

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

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

In the six months ended June 30, 2002, we did not increase our allowance for doubtful accounts. We base our allowance for doubtful accounts on specifically identified known doubtful accounts plus a general reserve for potential future doubtful accounts. We adjust our allowance for doubtful accounts when accounts previously reserved have been collected.

NON-CASH COMPENSATION EXPENSE, NET

During May 1999, we issued an option to purchase 94,500 shares of common stock at an exercise price of $1.60 per share to ShopNow.com Inc. (now known as Network Commerce Inc.), a client, in connection with an agreement to provide the LivePerson services to Network Commerce for two years. We were to receive subscription revenue from Network Commerce over the two-year period based on the number of LivePerson Chat operator access accounts the client was using. As discussed below, the option was amended in February 2000. The original

terms of the option provided that it would vest in or before May 2001, if revenue generated by Network Commerce met certain targets. We granted the option as an incentive for entering into a two-year service agreement with us, at a point in time when the LivePerson services were new and their viability was unknown. The option had no minimum revenue guarantee, and was exercisable for a period of three years from the date of grant. We accounted for this option in accordance with EITF Abstract No. 96-18, “Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.” Pursuant to EITF No. 96-18, we valued the option at each balance sheet date using a Black-Scholes pricing model using a volatility factor of 50%, a $1.60 per share exercise price and the then fair value of our common stock as of each balance sheet date. The $566,000 value ascribed to the option reflected the market value at December 31, 1999, less amortization expense of $86,000 for the period from May 1999 through December 1999, which was recorded as net deferred cost on our December 31, 1999 balance sheet. The unamortized value ascribed to this option was adjusted at each balance sheet date to bring the total ascribed value of the option up to the then current unamortized fair value. This cost was ratably amortized over the two-year service agreement, as we believed that the achievement of the revenue targets was probable. As a result, we amortized $86,000 of the deferred costs as of December 31, 1999, of which $24,000 was offset against the $27,000 of revenue recognized from the client in 1999, and the remaining $62,000 of sales and marketing expense was reflected as a non-cash compensation expense, all of which was recorded in the fourth quarter of 1999.

In February 2000, we amended the option agreement. Under the amendment, the option became fully vested and immediately exercisable, and Network Commerce exercised the option in May 2000. Network Commerce agreed, however, that it could not sell the underlying common stock until the earlier of five years or, if certain revenue criteria were met, May 19, 2001. The value ascribed to the option at the time the option agreement was amended, using a Black-Scholes pricing model, was $1,014,000, which was ratably amortized over the remaining service period of approximately fifteen months because the vesting of the option did not affect our obligation under the service agreement. In addition, the ratable amortization of the remaining deferred cost of $1,014,000 was recorded as a reduction of the revenue recognized from Network Commerce with any excess amortization recorded on a quarterly basis as sales and marketing expense, which was reflected as a non-cash compensation expense in our statement of operations. We amortized $723,000 of the deferred costs during the year ended December 31, 2000, of which $59,000 was offset against the $59,000 of revenue recognized from Network Commerce. The remaining $664,000 of sales and marketing expense was included in non-cash compensation expense in our 2000 statement of operations.

As of March 31, 2001, we determined that it was unlikely that Network Commerce would meet the remaining revenue requirements under the agreement. Accordingly, we amortized the remaining deferred cost of $291,000 during the three months ended March 31, 2001, of which $54,000 was offset against the $54,000 of revenue recognized from Network Commerce. The remaining $237,000 of sales and marketing expense was included in non-cash compensation expense in our statement of operations for the quarter ended March 31, 2001.

During 2000 and 1999, we granted or assumed stock options to purchase 5,730,727 and 3,496,245 shares of common stock at a weighted average exercise price of $3.62 and $1.37, per share, respectively, certain of which were granted at less than the deemed fair value of the common stock at the date of grant. For the years ended December 31, 2000 and 1999, we recorded deferred compensation of approximately $18.2 million and $6.2 million, respectively, in connection with the options granted at below the deemed fair value. The aggregate amount of unamortized deferred compensation related to the grant of options which was subsequently reversed against additional paid-in capital in connection with the forfeiture of those options granted at below the deemed fair value, and associated with employees who left LivePerson during the year ended December 31, 2000, was approximately $5.4 million. In 2000, we also recorded $272,000 of deferred compensation relating to the intrinsic value of unvested options assumed by us in connection with the HumanClick acquisition. These amounts are presented as deferred compensation within our consolidated financial statements and are being amortized over the vesting period, typically three to four years, of the applicable options. We amortized approximately $11.9 million and $1.6 million for the years ended December 31, 2000 and 1999, respectively, net of forfeitures or cancellations of approximately $2.0 million in connection with employees who left LivePerson in 2000.

Excluding the net non-cash compensation credit of approximately $1.7 million related to our restructuring initiatives in the first quarter of 2001, the net non-cash compensation credit of $332,000 and charge of $43,000 for the three and six months ended June 30, 2001, includes $0 and $237,000, respectively, related to the May 1999 option granted to Network Commerce (discussed above), $470,000 and $608,000, respectively, of amortization expense, $206,000 and $206,000, respectively, of charges related to acceleration of vesting of options in connection with the termination of the employment of certain employees, and approximately $1.0 million and $1.0 million, respectively, of credits due to forfeiture in connection with the termination of the employment of certain employees. The aggregate amount of unamortized deferred compensation reversed against additional paid-in capital in connection with the forfeiture of options associated with LivePerson employees who were terminated as part of our restructuring initiatives was $34,000 and $34,000 in the three and six months ended June 30, 2002, and $0 and approximately $2.6 million in the three and six months ended June 30, 2001.

RESULTS OF OPERATIONS

Due to our acquisition of HumanClick in October 2000, our significant restructuring initiatives during 2001, and our limited operating history, we believe that comparisons of our operating results for the three and six months ended June 30, 2002 and 2001 with each other, or with those of prior periods, are not meaningful and that our historical operating results should not be relied upon as indicative of future performance.

COMPARISON OF THREE AND SIX MONTHS ENDED JUNE 30, 2002 AND 2001

Revenue. Total revenue remained flat at $1.9 million in the three months ended June 30, 2002 compared to the three months ended June 30, 2001. Total revenue decreased to $3.7 million in the six months ended June 30, 2002 from $4.3 million in the comparable period in 2001. This decrease is primarily attributable to attrition of some of our Internet-related clients with limited operating histories (many of which began to face difficult business conditions in the first three quarters of 2001) and to a lesser extent, to fewer new clients due to poor business conditions and the reduction in our sales force as a result of our restructuring initiatives. We cannot assure you that we will experience any future growth in revenue.

Cost of Revenue. Cost of revenue consists of compensation costs relating to employees who provide customer service to our clients, compensation costs relating to our network support staff, the cost of supporting our infrastructure, including expenses related to leasing space and connectivity for our services, third-party monitoring services, as well as depreciation of certain hardware and software, and allocated occupancy costs and related overhead. Cost of revenue decreased to $318,000 and $656,000 in the three and six months ended June 30, 2002 from $2.1 million and $4.8 million in the comparable periods in 2001. This decrease is attributable to reduced spending requirements, including the cancellation of operating leases for certain computer equipment that supported our infrastructure, the consolidation of our clients onto a single customer application platform, reduced headcount and lower allocated occupancy costs related to overhead, each as a result of our restructuring initiatives.

Product Development. Our product development expenses consist primarily of compensation and related expenses for product development personnel. Product development costs decreased to $281,000 and $577,000 for the three and six months ended June 30, 2002 from $883,000 and $2.1 million in the comparable periods in 2001. This decrease is primarily attributable to a decrease in outsourced labor costs and to our restructuring initiatives, which resulted in fewer employees, streamlined operations and reduced spending requirements, including relocating software development activities to our Israel office in the second quarter of 2001.

Sales and Marketing. Our sales and marketing expenses consist of compensation and related expenses for sales and marketing personnel, as well as advertising, public relations and, to a lesser extent, trade show exhibit expenses. Sales and marketing expenses decreased to $493,000 and $1.1 million in the three and six months ended June 30, 2002 from $1.2 million and $3.3 million in the comparable periods in 2001. This decrease is primarily attributable to reduced print advertising expense and to our restructuring initiatives, which resulted in fewer employees, streamlined operations and reduced spending requirements.

General and Administrative. Our general and administrative expenses consist primarily of compensation and related expenses for executive, accounting, human resources and administrative personnel. General and administrative expenses decreased to $750,000 and $1.4 million in the three and six months ended June 30, 2002 from $1.6 million and $3.6 million in the comparable periods in 2001. This decrease is primarily attributable to our restructuring initiatives, which resulted in fewer employees, streamlined operations and reduced spending requirements, including the termination of our office lease agreement for our former principal executive offices.

Amortization of Goodwill and Other Intangibles. Amortization expense was $0 and $0 in the three and six months ended June 30, 2002 and $743,000 and $1.5 million in the three and six months ended June 30, 2001 and relates to goodwill recorded as a result of our acquisition of HumanClick in October 2000. The decrease is attributable to an accounting change related to the adoption of SFAS No. 142, described under the caption “Cumulative Effect of Accounting Change” below.

Non-Cash Compensation Expense, Net. Non-cash compensation expense primarily consists of amortization of deferred stock-based compensation. Deferred stock-based compensation represents the difference between the exercise price and the deemed fair value of certain stock options granted to employees. Deferred compensation is being amortized over the vesting period of the individual options. We recorded non-cash compensation expense of $116,000 and $218,000 in the three and six months ended June 30, 2002, an increase from a credit of $332,000 and expense of $43,000 in the comparable periods of 2001. This increase is due primarily to the reversal of previously recognized amortization of deferred compensation due to the forfeitures of employee stock options associated with employees who voluntarily left LivePerson in the second quarter of 2001 as well as employees whose employment was terminated as part of our restructuring initiatives in the first quarter of 2001. The net non-cash compensation amount for the three and six months ended June 30, 2001 excludes the net non-cash compensation credit of $1.7 million related to our restructuring initiatives in the first quarter of 2001.

Other Income. Interest income was $34,000 and $71,000 in the three and six months ended June 30, 2002 compared to $124,000 and $359,000 in the comparable periods in 2001 and consists of interest earned on cash and cash equivalents generated by the receipt of proceeds from our initial public offering in 2000 and preferred stock issuances in 2000 and 1999. Interest expense was $0 and $0 in the three and six months ended June 30, 2002 compared to $0 and $7,000 in the three and six months ended June 30, 2001.

Cumulative Effect of Accounting Change. On January 1, 2002, we were required to adopt the full provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that purchased goodwill and certain indefinite-lived intangibles no longer be amortized, but instead be tested for impairment at least annually. This testing requires the comparison of carrying values to fair value and, when appropriate, requires the reduction of the carrying value of impaired assets to their fair value.

The transitional impairment analysis required upon adoption of SFAS No. 142 was completed during the first quarter of 2002, and we determined that there was an impairment of the carrying value of goodwill. As part of this analysis, we determined that LivePerson continued to operate in one operating segment and that we do not have any separate reporting units under SFAS No. 142; accordingly, the impairment analysis was performed on an enterprise-wide basis. This process included obtaining an independent appraisal of our fair value as a whole and of our individual assets. Fair value was determined from the same cash flow forecasts used in December 2001 for the evaluation of our carrying value under SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," which was the accounting rule for impairment of goodwill that preceded SFAS No. 142 and was effective through December 31, 2001. The valuation methodology required by SFAS No. 142 is different than that required by SFAS No. 121. An impairment is more likely to result under SFAS No. 142 because it requires, among other items, the discounting of forecasted cash flows as compared to the undiscounted cash flow valuation method under SFAS No. 121, among other items.

The allocation of fair values to identifiable tangible and intangible assets as of January 1, 2002, resulted in an implied valuation of the goodwill of $0. The implied fair value of goodwill was determined in the same manner as determining the amount of goodwill that would have been required to be recognized in a business combination. That is, under SFAS No. 142, an entity is required to allocate the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire it. Comparing this implied value to the carrying value resulted in an impairment of $5.3 million, with no income tax effect. This impairment is recorded as a cumulative effect of accounting change on our statement of operations as of January 1, 2002.

Net Loss. Our net loss decreased to $51,000 and $5.5 million for the three and six months ended June 30, 2002 from $4.3 million and $12.4 million in the comparable periods in 2001. The net loss for the six months ended June 30, 2002 is primarily attributable to the cumulative effect of an accounting change of $5.3 million related to the

impairment of goodwill described above, partially offset by the fact that we did not record any amortization of goodwill in the first or second quarters of 2002. In comparison, we recorded $743,000 and $1.5 million of goodwill amortization for the three and six months ended June 30, 2001.

LIQUIDITY AND CAPITAL RESOURCES

Since our inception, we have financed our operations principally through cash generated by private placements of convertible preferred stock and the initial public offering of our common stock. Through June 30, 2002, we have raised a total of $69.5 million in aggregate net proceeds. We regularly invest excess funds in short-term money market funds, commercial paper, government securities, and short-term notes. As of June 30, 2002, we had approximately $10.4 million in cash and cash equivalents, an increase of almost $300,000 from December 31, 2001.

Net cash provided by operating activities was $308,000 for the six months ended June 30, 2002 and consisted primarily of net operating losses offset by the cumulative effect of an accounting change related to the impairment of goodwill and to a lesser extent, a decrease in accounts receivable, depreciation and amortization expenses partially offset by a decrease in accrued expenses. Net cash used in operating activities was $8.8 million for the six months ended June 30, 2001 and consisted primarily of net operating losses, non-cash items related to our restructuring initiatives, an increase in accounts receivable and decrease in accounts payable and deferred revenue, partially offset by an increase in accrued expenses, depreciation and amortization expenses.

Net cash used in investing activities was $29,000 for the six months ended June 30, 2002 and was due primarily to the purchase of fixed assets. Net cash used in investing activities was $1.7 million for the six months ended June 30, 2001 and was due to the purchase of restricted cash related to the lease of our former principal executive offices, and the purchase of fixed assets, offset by the sale of "available-for-sale" investment securities.

Net cash provided by financing activities was $12,000 for the six months ended June 30, 2002 and was due to proceeds from the issuance of common stock in connection with the exercise of options. Net cash provided by financing activities was $40,000 for the six months ended June 30, 2001 and was primarily attributable to proceeds from the issuance of common stock in connection with the exercise of options.

We lease facilities and certain equipment under agreements accounted for as operating leases. These leases generally require us to pay all executory costs such as maintenance and insurance. Rental expense for operating leases for the six months ended June 30, 2002 and 2001 was approximately $180,000 and $2.1 million, respectively.

As of June 30, 2002, our principal commitments were approximately $669,000 under various operating leases, of which approximately $178,000 is due in the second half of 2002. We do not currently expect that our principal commitments for the year ended December 31, 2002 will exceed $200,000 in the aggregate.

We have incurred significant costs to develop our technology and services, to hire employees in our customer service, sales, marketing and administration departments, and for the amortization of goodwill and other intangible assets, as well as non-cash compensation costs. In addition, our annual revenue growth in 2001 was less than in 2000, and our quarterly revenue declined in the second and third quarters of 2001 and did not increase materially in the first and fourth quarters of 2001 and the first and second quarters of 2002. As a result, we have incurred significant net losses in the periods from inception through March 31, 2002, significant negative cash flows from operations in the periods from inception through December 31, 2001, and as of June 30, 2002, we had an accumulated deficit of $103.9 million. These losses have been funded primarily through the issuance of common stock in our initial public offering and, prior to the initial public offering, the issuance of convertible preferred stock.

In the first quarter of 2001, following a review of our business in connection with our acquisition of HumanClick, we commenced restructuring initiatives to streamline our operations, including the consolidation of our two San Francisco Bay area offices. The restructuring resulted in a reduction of our workforce by approximately 90 people as of the end of the first quarter of 2001. In the third quarter of 2001, in a continued effort to streamline our operations, we initiated additional restructuring initiatives. These initiatives resulted in the elimination of redundant staff positions, the consolidation of all clients onto a single application platform and the move of our principal executive offices, which included the termination of an office space lease. These initiatives resulted in a reduction of our workforce by approximately 20 people, the write-off of impaired computer equipment and software and the write-off of certain furniture, equipment and building improvements.

As a result of the various restructuring initiatives, for the year ended December 31, 2001, we recorded charges of approximately $12.7 million for expenses related to the restructuring and impairment, all of which are expected to be paid by the end of 2002. In addition, for the year ended December 31, 2001, we also recognized a net non-cash compensation credit in the amount of approximately $1.7 million associated with LivePerson employees who were terminated as part of our restructuring initiatives in first quarter of 2001. The net non-cash compensation credit of $1.7 million for the year ended December 31, 2001 represents the reversal of $3.2 million of previously recognized amortization of deferred compensation related to employee stock options which did not vest due to the termination of their employment in connection with our restructuring initiatives, offset by the acceleration of vesting of certain other employee options of $1.5 million also in connection with the restructuring initiatives. Approximately $446,000 of the $1.5 million represents additional compensation related to the intrinsic value of options at the date of modification during 2001.

Although we believe that we have provided adequate reserves in connection with our legal proceedings, we cannot assure you that the ultimate liabilities in connection with these matters will not exceed our reserves or have a material adverse effect on our business, results of operations, financial condition, or cash flows. See "Part II. Other Information - Item 1. Legal Proceedings" for additional information.

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

RISK FACTORS THAT MAY AFFECT FUTURE RESULTS

RISKS RELATED TO OUR POSSIBLE DELISTING FROM NASDAQ

WE FACE POSSIBLE NASDAQ DELISTING WHICH WOULD RESULT IN A LIMITED PUBLIC MARKET FOR OUR COMMON STOCK AND MAKE OBTAINING FUTURE EQUITY FINANCING MORE DIFFICULT FOR US.

We must satisfy a number of requirements to maintain our listing on the Nasdaq Stock Market (comprised of the Nasdaq National Market and the Nasdaq SmallCap Market), including maintaining a minimum bid price for our common stock of $1.00 per share. A company fails to satisfy this requirement if its closing bid price remains below $1.00 per share for 30 consecutive trading days.

Our common stock commenced trading on the Nasdaq SmallCap Market on May 28, 2002, following approval by The Nasdaq Stock Market, Inc. of our May 14, 2002 application to transfer the listing of our common stock from the Nasdaq National Market to the Nasdaq SmallCap Market. We determined to apply voluntarily for transfer to the Nasdaq SmallCap Market so as to avoid anticipated Nasdaq National Market delisting proceedings and to take advantage of the Nasdaq SmallCap Market rule which provides an extended grace period for compliance with the $1.00 per share minimum bid requirement. We had received a letter from Nasdaq on February 14, 2002, notifying us that during the preceding 30 consecutive trading days, the bid price of our common stock had closed below the minimum bid price of $1.00 per share as required by the Nasdaq National Market under Nasdaq Marketplace Rule 4450(a)(5). The letter stated that we had until May 15, 2002 to demonstrate compliance with such rule and that, if we were not in compliance by that date, Nasdaq would notify us that our securities would be delisted from the Nasdaq National Market. The letter also stated that we could apply to transfer the listing of our common stock to the Nasdaq SmallCap Market.

Our application to transfer the listing of our common stock to the Nasdaq SmallCap Market stayed Nasdaq National Market delisting proceedings related to non-compliance with the Nasdaq National Market’s $1.00 per share minimum bid price requirement. We have until August 13, 2002 to satisfy the Nasdaq SmallCap Market’s $1.00 per share minimum bid price requirement. After that, we could also be eligible for an additional 180 calendar day grace period provided that at such time we meet the initial listing requirements for the Nasdaq SmallCap Market under Nasdaq Marketplace Rule 4310(c)(2)(A), which requires, generally, an issuer to have (i) stockholders’ equity of $5 million, (ii) a market capitalization of $50 million or (iii) net income of $750,000 (excluding extraordinary or non-recurring items) in the most recently completed fiscal year or in two of the three most recently completed fiscal years. We currently meet all of the initial and continued inclusion criteria for the Nasdaq SmallCap Market except for the minimum bid price requirement.

If a delisting from the Nasdaq National Market or the Nasdaq SmallCap Market were to occur, shares of our common stock would likely trade in the over-the-counter market in the so-called “pink sheets” maintained by Pink Sheets LLC, or on the OTC Bulletin Board owned by The Nasdaq Stock Market, Inc., which was established for securities that do not meet the listing requirements of the Nasdaq National Market or the Nasdaq SmallCap Market. The “pink sheets” and the OTC Bulletin Board are generally considered less efficient than the Nasdaq National Market and the Nasdaq SmallCap Market. Consequently, selling our common stock would be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and securities analysts’ and news media coverage of us may be reduced. These factors could result in lower prices and larger spreads in the bid and ask prices for shares of common stock.

Such delisting from the Nasdaq National Market or the Nasdaq SmallCap Market, or further declines in our stock price, could also greatly impair our ability to raise additional necessary capital through equity or debt financing, and significantly increase the ownership dilution to stockholders caused by our issuing equity in financing or other transactions. The price at which we issue shares in such transactions is generally based on the market price of our common stock and a decline in our stock price could result in the need for us to issue a greater number of shares to raise a given amount of funding or acquire a given dollar value of goods or services.

In addition, if our common stock is not listed on the Nasdaq National Market or the Nasdaq SmallCap Market, we may become subject to Rule 15g-9 under the Securities and Exchange Act of 1934, as amended. That rule imposes additional sales practice requirements on broker-dealers that sell low-priced securities to persons other than established customers and institutional accredited investors. For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. Consequently, the rule may affect the ability of broker-dealers to sell the common stock and affect the ability of holders to sell their shares of our common stock in the secondary market. Moreover, investors may be less interested in purchasing low-priced securities because the brokerage commissions, as a percentage of the total transaction value, tend to be higher for such securities, and some investment funds will not invest in low-priced securities (other than those which focus on small-capitalization companies or low-priced securities).

RISKS RELATED TO OUR BUSINESS

WE HAVE A LIMITED OPERATING HISTORY AND EXPECT TO ENCOUNTER DIFFICULTIES FACED BY EARLY STAGE COMPANIES IN NEW AND RAPIDLY EVOLVING MARKETS.

We have only a limited operating history providing the LivePerson services upon which to base an evaluation of our current business and future prospects. We began offering our services in November 1998 and we acquired HumanClick in October 2000; accordingly, the revenue and income potential of our business and the related market are unproven. As a result of our limited operating history as an application service provider of real-time sales and customer service technology for companies doing business on the Internet, we have only three years of historical financial data relating to the LivePerson services upon which to forecast revenue and results of operations.

In addition, because this market is relatively new and rapidly evolving, we have limited insight into trends that may emerge and affect our business. Before investing in us, you should evaluate the risks, expenses and

problems frequently encountered by companies such as ours that are in the early stages of development and that are entering new and rapidly changing markets. These risks include our ability to:

- attract more clients and retain existing clients;
- sell additional operator access accounts for LivePerson Chat, which generate monthly fees, and other services to our existing clients;
- increase or maintain current pricing levels for our services;
- effectively market and maintain our brand name;
- respond effectively to competitive pressures;
- continue to develop and upgrade our technology; and
- attract, integrate, retain and motivate qualified personnel.

If we are unsuccessful in addressing some or all of these risks, our business, financial condition and results of operations would be materially and adversely affected.

WE HAVE A HISTORY OF LOSSES, WE HAD AN ACCUMULATED DEFICIT OF $103.9 MILLION AS OF JUNE 30, 2002 AND WE MAY INCUR LOSSES IN THE FUTURE.

We have not achieved profitability, and we may, in the future, incur losses and experience negative cash flow, either or both of which may be significant. We recorded a net loss of $9.8 million for the year ended December 31, 1999, $43.3 million for the year ended December 31, 2000, $27.3 million for the year ended December 31, 2001 and $5.5 million for the six months ended June 30, 2002. We had total revenue of approximately $3.7 million for the six months ended June 30, 2002, $7.8 million for the year ended December 31, 2001, and less than $6.3 million and $615,000 in the years ended December 31, 2000 and 1999, respectively. Our net loss for the year ended December 31, 2000 included a non-cash dividend of $18.0 million. As of June 30, 2002, our accumulated deficit was approximately $103.9 million. Even if we do achieve profitability, we cannot assure you that we can sustain or increase profitability on a quarterly or annual basis in the future. Failure to achieve or maintain profitability may materially and adversely affect the market price of our common stock.

WE CANNOT PREDICT OUR FUTURE CAPITAL NEEDS TO EXECUTE OUR BUSINESS STRATEGY AND WE MAY NOT BE ABLE TO SECURE ADDITIONAL FINANCING.

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

WE HAVE AN UNPROVEN BUSINESS MODEL AND MAY NOT GENERATE SUFFICIENT REVENUE FOR OUR BUSINESS TO SURVIVE.

Our business model is based on the delivery of real-time sales and customer service technology and related services to companies doing business on the Internet, a largely untested business. Sales and customer service historically have been provided primarily in person or by telephone. Our business model assumes that companies doing business on the Internet will choose to provide sales and customer service via the Internet. Our business model also assumes that many companies will recognize the benefits of an outsourced application, that Internet users will choose to engage a customer service representative in a live text-based interaction, that this interaction will maximize sales opportunities and enhance the online shopping experience and that companies will seek to have their online sales and customer service technology provided by us. If any of these assumptions is incorrect, our business may be harmed. In addition, we recently began offering the LivePerson services via Internet download, which is an unproven model for the delivery of our services.

WE EXPECT THAT A SUBSTANTIAL MAJORITY OF OUR REVENUE WILL COME FROM THE LIVEPERSON CHAT SERVICE FOR THE FORESEEABLE FUTURE AND IF WE ARE NOT SUCCESSFUL IN SELLING THIS SERVICE, OUR REVENUE WILL NOT INCREASE AND MAY DECLINE.

The success of our business currently substantially depends, and for the foreseeable future will continue to substantially depend, on the sale of only one service, LivePerson Chat. We cannot be certain that there will be client demand for our services or that we will be successful in penetrating the market for real-time sales and customer service technology. Our revenue declined in each of the second and third quarters of 2001, and did not increase materially in the first and fourth quarters of 2001 and the first and second quarters of 2002; we cannot assure you that we will experience any revenue growth in the future. A decline in the price of, or fluctuation in the demand (by existing or potential clients) for, our services, is likely to cause our revenue to decline.

THE SUCCESS OF OUR BUSINESS REQUIRES THAT CLIENTS CONTINUE TO USE THE LIVEPERSON SERVICES AND PURCHASE ADDITIONAL SERVICES.

Our LivePerson services agreements typically have no termination date and are terminable upon 30 to 90 days' notice without penalty. If a significant number of our clients, or any one client to whom we provide a significant amount of services, were to terminate these services agreements, or reduce the amount of services purchased or fail to purchase additional services, our results of operations may be negatively and materially affected. Dissatisfaction with the nature or quality of our services, including our new software application platform introduced in the third quarter of 2001, could also lead clients to terminate our service. We depend on monthly fees from the LivePerson services for substantially all our revenue. If our retention rate declines further, our revenue could decline unless we are able to obtain additional clients or alternate revenue sources. Further, because of the historically small amount of services sold in initial orders, we depend on sales to new clients and sales of additional services to our existing clients.

OUR QUARTERLY REVENUE AND OPERATING RESULTS ARE SUBJECT TO SIGNIFICANT FLUCTUATIONS WHICH MAY ADVERSELY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

We expect our quarterly revenue and operating results to fluctuate significantly in the future due to a variety of factors, including the following factors which are in part within our control, and in part outside of our control:

- market acceptance by companies doing business on the Internet of real-time sales and customer service technology;
- our clients' business success;
- our clients' demand for LivePerson Chat operator access accounts and our other services;

- our ability to attract and retain clients;
- the amount and timing of capital expenditures and other costs relating to the expansion of our operations, including those related to acquisitions;
- the introduction of new services by us or our competitors; and
- changes in our pricing policies or the pricing policies of our competitors.

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

- seasonal factors affecting our clients' businesses;
- economic conditions specific to the Internet, electronic commerce and online media; and
- general economic and political conditions.

Many of our clients' businesses are seasonal. Our clients' demand for real-time sales and customer service technology in general and their demand for our services, in particular, may be seasonal as well. As a result, our future revenue and profits may vary from quarter to quarter.

We do not believe that period-to-period comparisons of our operating results are meaningful. You should not rely upon these comparisons as indicators of our future performance.

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

OUR CLIENTS MAY EXPERIENCE ADVERSE BUSINESS CONDITIONS THAT COULD ADVERSELY AFFECT OUR BUSINESS.

Some of our clients may experience difficulty in supporting their current operations and implementing their business plans. These clients may reduce their spending on our services, or may not be able to discharge their payment and other obligations to us. These circumstances are influenced by general economic and industry-specific conditions, and could have a material adverse impact on our business, financial condition and results of operations. In addition, as a result of these conditions, our clients, in particular our Internet-related clients that may experience (or that anticipate experiencing) difficulty raising capital, may elect to scale back the resources they devote to customer service technology, including services such as ours. If the current environment for our clients, including, in particular, our Internet-related clients, does not improve, our business, results of operations and financial condition could be materially adversely affected. In addition, the non-payment or late payment of amounts due to us from a significant number of clients would negatively impact our financial condition. In the year ended December 31, 2001, we increased our allowance for doubtful accounts to approximately $1.5 million from $577,000 at December 31, 2000. A significant portion of this increase was due to overdue accounts receivable balances for our Internet-related clients with limited operating histories, many of which began to face difficult business conditions in the past year, and, in particular, during the nine months ended September 30, 2001. During 2001, we wrote off approximately $1.3 million of previously reserved accounts, leaving a net allowance of $160,000 at December 31, 2001. We did not increase our allowance for doubtful accounts in each of the three months ended June 30, 2002, March 31, 2002 and December 31, 2001. This is attributable to the fact that our accounts receivable collections improved in these periods, due primarily to the significantly larger percentage of our total outstanding accounts receivable now comprised of businesses with more established and proven operating histories, and to a lesser extent, to the fact that an increased number of our clients now pay us by credit card.

WE MAY NOT BE ABLE TO EFFECTIVELY MANAGE OUR CHANGING OPERATIONS.

Since the launch of our services in November 1998, we have grown rapidly, even in light of our recent restructuring initiatives. This growth has placed a significant strain on our managerial, operational, technical and financial resources. In 2000, we replaced our existing accounting and other back-office systems at a cost of approximately $1.2 million. In 2001, in connection with our restructuring initiatives, we implemented a less expensive accounting system. The cost of this new system was immaterial. The new systems are being integrated with our operations, controls and procedures. If we are not able to successfully integrate these new systems with our existing systems, or if we incur significant additional costs in order to achieve such integration, our business could be harmed. In order to manage our growth, we must also continue to implement new or upgraded operating and financial systems, procedures and controls. Our failure to expand our operations in an efficient manner could cause our expenses to grow, our revenue to decline or grow more slowly than expected and could otherwise have a material adverse effect on our business, results of operations and financial condition.

STAFF ATTRITION COULD STRAIN OUR MANAGERIAL, OPERATIONAL, FINANCIAL AND OTHER RESOURCES.

We had 73 employees at December 31, 1999; 181 employees at December 31, 2000; 68 employees at December 31, 2001; and 62 employees at June 30, 2002. In the area of technology, we had 19 employees at December 31, 1999; 40 employees at December 31, 2000; 12 employees at December 31, 2001; and 13 employees at June 30, 2002. Any staff attrition we experience, whether initiated by the departing employees or by us, could place a significant strain on our managerial, operational, financial and other resources. To the extent that we do not initiate or seek any staff attrition that occurs, there can be no assurance that we will be able to identify and hire adequate replacement staff promptly, if at all, and even that if such staff is replaced, we will be successful in integrating these employees. In both the first and third quarters of 2001, in addition to conducting regularly-occurring performance-related terminations, we commenced restructuring plans pursuant to which we eliminated a large number of positions in response to changes in our business needs, such as redundancies in our research and development and client support functions and the transition of a portion of our sales efforts from direct sales to more automated Internet-based sales processes. We expect to evaluate our needs and the performance of our staff on a periodic basis, and may choose to make further adjustments in the future. If the size of our staff is significantly further reduced, either by our choice or otherwise, we could face significant management, operational, financial and other constraints. For example, it may become more difficult for us to manage existing, or establish new, relationships with clients and other counter-parties, or to expand and improve our service offerings. It may also become more difficult for us to implement changes to our business plan or to respond promptly to opportunities in the marketplace. Further, it may become more difficult for us to devote personnel resources necessary to maintain or improve existing systems, including our financial and managerial controls, billing systems, reporting systems and procedures. Thus, any significant amount of staff attrition could cause our business and financial results to suffer.

OUR BUSINESS IS DEPENDENT ON A FEW KEY EMPLOYEES, INCLUDING OUR CHIEF EXECUTIVE OFFICER, ROBERT P. LOCASCIO.

Our future success depends to a significant extent on the continued services of our senior management team, including Robert P. LoCascio, our founder and Chief Executive Officer. The loss of the services of any member of our senior management team, in particular Mr. LoCascio, could have a material and adverse effect on our business, results of operations and financial condition. In addition, since November 2000, many members of our senior management team left LivePerson. Although we do not believe that changes in our senior management team have materially harmed our business, they have distracted us from other important tasks, and we cannot assure you that we will be able to successfully integrate newly-hired senior managers who will work together successfully with our existing management team.

IF WE DO NOT SUCCESSFULLY INTEGRATE POTENTIAL FUTURE ACQUISITIONS, OUR BUSINESS COULD BE HARMED.

In the future, we may acquire or invest in complementary companies, products or technologies. Acquisitions and investments involve numerous risks to us, including:

- difficulties in integrating operations, technologies, products and personnel with LivePerson;
- diversion of financial and management resources from efforts related to the LivePerson services or other then-existing operations; risks of entering new markets beyond providing real-time sales and customer service technology for companies doing business on the Internet;

- potential loss of either our existing key employees or key employees of any companies we acquire; and

- our inability to generate sufficient revenue to offset acquisition or investment costs.

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

WE COULD FACE ADDITIONAL REGULATORY REQUIREMENTS, TAX LIABILITIES AND OTHER RISKS AS WE EXPAND INTERNATIONALLY.

In October 2000, we acquired HumanClick, an Israeli-based provider of real-time online customer service applications with more than 100,000 customers around the world and 27 employees at the date of acquisition. In addition, during a portion of 2000 and 2001, we conducted operations in the United Kingdom. There are risks related to doing business in international markets, such as changes in regulatory requirements, tariffs and other trade barriers, fluctuations in currency exchange rates, more stringent rules relating to the privacy of Internet users and adverse tax consequences. In addition, there are likely to be different consumer preferences and requirements in specific international markets. Furthermore, we may face difficulties in staffing and managing any foreign operations. One or more of these factors could harm any future international operations.

IF WE DO NOT SUCCEED IN ATTRACTING NEW PERSONNEL OR RETAINING AND MOTIVATING OUR CURRENT PERSONNEL, OR IF WE ARE UNABLE TO OUTSOURCE CERTAIN FUNCTIONS, OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION WILL BE MATERIALLY AND ADVERSELY AFFECTED.

We may be unable to retain our key employees or attract, integrate or retain other highly qualified employees in the future. We have experienced difficulty in hiring and retaining highly-skilled senior managers and other employees with appropriate qualifications. Also, our workforce reductions announced in the first and third quarters of 2001 may adversely affect the morale of, and our ability to retain, those employees who were not terminated. Because our stock price has suffered a significant decline, the stock options held by our employees and other equity-based compensation may have diminished effectiveness as employee retention devices. If our retention efforts are ineffective, employee turnover could increase and our ability to provide services to our clients would be materially and adversely affected.

OUR REPUTATION DEPENDS, IN PART, ON FACTORS WHICH ARE ENTIRELY OUTSIDE OF OUR CONTROL.

Our services appear as a LivePerson-branded or a custom-created icon on our clients' Web sites. The customer service operators who respond to the inquiries of our clients' Internet users are employees or agents of our clients; they are not our employees. As a result, we have no way of controlling the actions of these operators. In addition, an Internet user may not know that the operator is an employee or agent of our client, rather than a LivePerson employee. If an Internet user were to have a negative experience in a LivePerson-powered or HumanClick-powered real-time dialogue, it is possible that this experience could be attributed to us, which could diminish our brand and harm our business. Finally, we believe the success of our services depend on the prominent placement of the icon on the client's Web site, over which we also have no control.

WE MAY BE UNABLE TO CONTINUE TO BUILD AWARENESS OF THE LIVEPERSON BRAND NAME.

Building recognition of our brand is critical to establishing the advantage of being among the first application service providers to provide real-time sales and customer service and to attracting new clients. If we fail to successfully promote and maintain our brand or incur significant expenses in promoting our brand without an associated increase in our revenue, our business, results of operations and financial condition may be materially and adversely affected.

WE ARE DEPENDENT ON TECHNOLOGY SYSTEMS THAT ARE BEYOND OUR CONTROL.

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

In addition, we rely on a third-party Web hosting service provider for Internet connectivity and network infrastructure hosting, security and maintenance. The provider has, in the past, experienced problems that have resulted in slower than normal response times and interruptions in service. If we are unable to continue utilizing the services of our existing Web hosting provider or if our Web hosting services experience interruptions or delays, it is possible that our business could be harmed.

Our service also depends on many third parties for hardware and software, which products could contain defects. Problems arising from our use of such hardware or software could require us to incur significant costs or divert the attention of our technical personnel from our product development efforts. To the extent any such problems require us to replace such hardware or software, we may not be able to do so on acceptable terms, if at all.

TECHNOLOGICAL DEFECTS COULD DISRUPT OUR SERVICES, WHICH COULD HARM OUR BUSINESS AND REPUTATION.

We face risks related to the technological capabilities of the LivePerson services. We expect the number of simultaneous chats between our clients' operators and Internet users over our system to increase significantly as we expand our client base. Our network hardware and software may not be able to accommodate this additional volume. Additionally, we must continually upgrade our software to improve the features and functionality of the LivePerson services in order to be competitive in our market. If future versions of our software contain undetected errors, our business could be harmed. As a result of major software upgrades at LivePerson, our client sites have, from time to time, experienced slower than normal response times and interruptions in service. If we experience system failures or degraded response times, our reputation and brand could be harmed. We may also experience technical problems in the process of installing and initiating the LivePerson services on new Web hosting services. These problems, if unremedied, could harm our business.

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

- damage to our reputation;
- lost sales;
- delays in or loss of market acceptance of our products; and

- unexpected expenses and diversion of resources to remedy errors.

WE MAY BE UNABLE TO RESPOND TO THE RAPID TECHNOLOGICAL CHANGE AND CHANGING CLIENT PREFERENCES IN THE ONLINE SALES AND CUSTOMER SERVICE INDUSTRY AND THIS MAY HARM OUR BUSINESS.

If we are unable, for technological, legal, financial or other reasons, to adapt in a timely manner to changing market conditions in the online sales and customer service industry or our clients' or Internet users' requirements, our business, results of operations and financial condition would be materially and adversely affected. Business on the Internet is characterized by rapid technological change. In addition, the market for online sales and customer service technology is relatively new. Sudden changes in client and Internet user requirements and preferences, frequent new product and service introductions embodying new technologies, such as broadband communications, and the emergence of new industry standards and practices could render the LivePerson services and our proprietary technology and systems obsolete. The rapid evolution of these products and services will require that we continually improve the performance, features and reliability of our services. Our success will depend, in part, on our ability to:

- enhance the features and performance of the LivePerson services;
- develop and offer new services that are valuable to companies doing business on the Internet and Internet users; and
- respond to technological advances and emerging industry standards and practices in a cost-effective and timely manner.

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

IF WE ARE NOT COMPETITIVE IN THE MARKET FOR REAL-TIME SALES AND CUSTOMER SERVICE TECHNOLOGY, OUR BUSINESS COULD BE HARMED.

There are no substantial barriers to entry in the real-time sales and customer service technology market, other than the ability to design and build scalable software and, with respect to outsourced solution providers, the ability to design and build scalable network architecture. Established or new entities may enter this market in the near future, including those that provide real-time interaction online, with or without the user's request.

We compete directly with companies focused on technology that facilitates real-time sales and customer service interaction. Our competitors include customer service enterprise software providers such as eGain Communications Corp., Divine, Inc., KANA Software, Inc., and RightNow Technologies, Inc., some of which offer hosted solutions. Furthermore, many of our competitors offer a broader range of customer relationship management products and services than we currently offer. We may be disadvantaged and our business may be harmed if companies doing business on the Internet choose sales and customer service technology from such providers.

We also face potential competition from larger enterprise software companies such as Oracle and Siebel Systems. In addition, established technology companies, including IBM and Microsoft, may also leverage their existing relationships and capabilities to offer real-time sales and customer service applications.

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

We believe that competition will increase as our current competitors increase the sophistication of their offerings and as new participants enter the market. Many of our current and potential competitors have:

- longer operating histories;

- larger client bases;
- greater brand recognition;
- more diversified lines of products and services; and
- significantly greater financial, marketing and other resources.

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

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

Any delay in the general market acceptance of the real-time sales and customer service solution business model would likely harm our competitive position. Delays would allow our competitors additional time to improve their service or product offerings, and would also provide time for new competitors to develop real-time sales and customer service applications and solicit prospective clients within our target markets. Increased competition could result in pricing pressures, reduced operating margins and loss of market share.

OUR BUSINESS AND PROSPECTS WOULD SUFFER IF WE ARE UNABLE TO PROTECT AND ENFORCE OUR INTELLECTUAL PROPERTY RIGHTS.

Our success and ability to compete depend, in part, upon the protection of our intellectual property rights relating to the technology underlying the LivePerson services. We currently have a U.S. patent application pending relating to such technology and have not filed applications outside the U.S. The U.S. Patent and Trademark Office has issued an office action rejecting our patent application to which we have filed a response. It is possible that:

- our pending patent application may not result in the issuance of a patent;
- any patent issued may not be broad enough to protect our intellectual property rights;
- any patent issued could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the invention claimed in the patent;
- current and future competitors may independently develop similar technology, duplicate our service or design around any patent we may have; and
- effective patent protection may not be available in every country in which we do business.

Further, to the extent that the invention described in our U.S. patent application was made public prior to the filing of the application, we may not be able to obtain patent protection in certain foreign countries. We also rely upon copyright, trade secret and trademark law, written agreements and common law to protect our proprietary technology, processes and other intellectual property, to the extent that protection is sought or secured at all. We currently have two U.S. trademarks — “LivePerson Give Your Site A Pulse” and “HumanClick” — registered on the U.S. Patent and Trademark Office primary register. We currently have one U.S. trademark — “LivePerson” — registered on the U.S. Patent and Trademark Office supplemental register. We do not have any trademarks registered outside the U.S., nor do we have any trademark applications pending outside the U.S. We cannot assure you that any steps we might take will be adequate to protect against infringement and misappropriation of our intellectual property by third parties. Similarly, we cannot assure you that third parties will not be able to independently develop similar or superior technology, processes or other intellectual property. The unauthorized reproduction or other misappropriation of our intellectual property rights could enable third parties to benefit from our technology

without paying us for it. If this occurs, our business, results of operations and financial condition could be materially and adversely affected. In addition, disputes concerning the ownership or rights to use intellectual property could be costly and time-consuming to litigate, may distract management from operating our business and may result in our loss of significant rights.

OUR PRODUCTS AND SERVICES MAY INFRINGE UPON INTELLECTUAL PROPERTY RIGHTS OF THIRD PARTIES AND ANY INFRINGEMENT COULD REQUIRE US TO INCUR SUBSTANTIAL COSTS AND MAY DISTRACT OUR MANAGEMENT.

Although we attempt to avoid infringing known proprietary rights of third parties, we do not conduct comprehensive patent searches to determine whether our services and technology infringe patents held by others, and we are subject to the risk of claims alleging infringement of third-party proprietary rights. If we infringe upon the rights of third parties, we may not be able to obtain licenses to use those rights on commercially reasonable terms. In that event, we would need to undertake substantial reengineering to continue offering our services. Any effort to undertake such reengineering might not be successful. In addition, any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract our management from our business. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our products. If any of these events occurred, our business, results of operations and financial condition would be materially and adversely affected.

WE MAY BE LIABLE IF THIRD PARTIES MISAPPROPRIATE PERSONAL INFORMATION BELONGING TO OUR CLIENTS’ INTERNET USERS.

We maintain dialogue transcripts of the text-based chats between our clients and Internet users and store on our servers information supplied voluntarily by these Internet users in exit surveys which follow the chats. We provide this information to our clients to allow them to perform Internet user analyses and monitor the effectiveness of our services. Some of the information we collect in text-based chats and exit surveys may include personal information, such as contact and demographic information. If third parties were able to penetrate our network security or otherwise misappropriate personal information relating to our clients’ Internet users or the text of customer service inquiries, we could be subject to liability. We could be subject to negligence claims or claims for misuse of personal information. These claims could result in litigation which could have a material adverse effect on our business, results of operations and financial condition. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by such breaches.

The need to physically secure and securely transmit confidential information online has been a significant barrier to electronic commerce and online communications. Any well-publicized compromise of security could deter people from using online services such as the ones we offer, or from using them to conduct transactions which involve transmitting confidential information. Because our success depends on the general acceptance of our services and electronic commerce, we may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by these breaches.

POLITICAL, ECONOMIC AND MILITARY CONDITIONS IN ISRAEL COULD NEGATIVELY IMPACT OUR ISRAELI OPERATIONS.

Our product development staff, help desk and online sales personnel are located in Israel. Although substantially all of our sales to date have been made to customers outside Israel, we are directly influenced by the political, economic and military conditions affecting Israel. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity, has caused security and economic problems in Israel. Further, since September 2000, there has been a significant deterioration in the relationship between Israel and the Palestinian Authority and serious violence has ensued, the peace process between the parties has stagnated, and Israel's relationship with several Arab countries has been adversely affected. Moreover, hostilities during 2002 have escalated significantly, with increased attacks in Israel and an armed conflict between Israel and the Palestinians in the West Bank and Gaza. Efforts to resolve the conflict have failed to result in an agreeable solution. Continued hostilities between the Palestinian community and Israel and any failure to settle the conflict could adversely affect our operations in Israel and our

business. Further deterioration of the situation into a full-scale armed conflict might require more widespread military reserve service by some of our Israeli employees and might result in a significant downturn in the economic or financial condition of Israel, either of which could have a material adverse effect on our operations in Israel and our business. In addition, several Arab countries still restrict business with Israeli companies. Our operations in Israel could be adversely affected by restrictive laws or policies directed towards Israel and Israeli businesses.

RISKS RELATED TO OUR INDUSTRY

WE ARE DEPENDENT ON CONTINUED GROWTH IN THE USE OF THE INTERNET AS A MEDIUM FOR COMMERCE.

We cannot be sure that a sufficiently broad base of consumers will adopt, and continue to use, the Internet as a medium for commerce. Our long-term viability depends substantially upon the widespread acceptance and development of the Internet as an effective medium for consumer commerce. Use of the Internet to effect retail transactions is at an early stage of development. Convincing our clients to offer real-time sales and customer service technology may be difficult.

Demand for recently introduced services and products over the Internet is subject to a high level of uncertainty. Few proven services and products exist. The development of the Internet into a viable commercial marketplace is subject to a number of factors, including:

- continued growth in the number of users;
- concerns about transaction security;
- continued development of the necessary technological infrastructure;
- development of enabling technologies;
- uncertain and increasing government regulation; and
- the development of complementary services and products.

WE DEPEND ON THE CONTINUED VIABILITY OF THE INFRASTRUCTURE OF THE INTERNET.

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

WE MAY BECOME SUBJECT TO BURDENSOME GOVERNMENT REGULATION AND LEGAL UNCERTAINTIES.

Laws and regulations directly applicable to Internet communications, commerce and advertising are becoming more prevalent. Recently, the United States Congress enacted Internet legislation relating to issues such as children's privacy, copyright and taxation. The children's privacy legislation imposes restrictions on the

collection, use and distribution of personal identification information obtained online from children under the age of 13. The copyright legislation establishes rules governing the liability of Internet service providers and Web site publishers for the copyright infringement of Internet users. The tax legislation places a moratorium on certain forms of Internet taxes for three years; however, this moratorium does not apply to sales and use taxes. Additionally, the European

Union has adopted a directive addressing data privacy which imposes restrictions on the collection, use and processing of personal data. Existing legislation and any new legislation could hinder the growth in use of the Internet generally and decrease the acceptance of the Internet as a medium for communication, commerce and advertising. The laws governing the Internet remain largely unsettled, even in areas where legislation has been enacted. It may take several years to determine whether and how existing laws such as those governing intellectual property, taxation and personal privacy apply to the Internet and Internet services. In addition, the growth and development of the market for Internet commerce may prompt calls for more stringent consumer protection laws, both in the U.S. and abroad, which may impose additional burdens on companies conducting business online. Our business, results of operations and financial condition could be materially and adversely affected if we do not comply with recent legislation or laws or regulations relating to the Internet that are adopted or modified in the future.

For example, the LivePerson services allow our clients to capture and save information about Internet users, possibly without their knowledge. Additionally, our service uses a tool, commonly referred to as a “cookie,” to uniquely identify each of our clients’ Internet users. To the extent that additional legislation regarding Internet user privacy is enacted, such as legislation governing the collection and use of information regarding Internet users through the use of cookies, the effectiveness of the LivePerson services could be impaired by restricting us from collecting information which may be valuable to our clients. The foregoing could harm our business, results of operations and financial condition.

SECURITY CONCERNS COULD HINDER COMMERCE ON THE INTERNET.

User concerns about the security of confidential information online has been a significant barrier to commerce on the Internet and online communications. Any well-publicized compromise of security could deter people from using the Internet or other online services or from using them to conduct transactions that involve the transmission of confidential information. If Internet commerce is inhibited as a result of such security concerns, our business would be harmed.

OTHER RISKS

OUR EXECUTIVE OFFICERS, DIRECTORS AND 5% OR GREATER STOCKHOLDERS WILL BE ABLE TO INFLUENCE MATTERS REQUIRING A STOCKHOLDER VOTE.

Our executive officers, directors and stockholders who each own greater than 5% of the outstanding common stock and their affiliates, in the aggregate, beneficially own approximately 45.4% of our outstanding common stock. As a result, these stockholders, if acting together, will be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions. This concentration of ownership could also have the effect of delaying or preventing a change in control.

THE FUTURE SALE OF SHARES OF OUR COMMON STOCK MAY NEGATIVELY AFFECT OUR STOCK PRICE.

If our stockholders sell substantial amounts of our common stock, including shares issuable upon the exercise of outstanding options and warrants in the public market, or if our stockholders are perceived by the market as intending to sell substantial amounts of our common stock, the market price of our common stock could fall. These sales also might make it more difficult for us to sell equity securities in the future at a time and price that we deem appropriate. “Affiliates” of LivePerson may not sell their shares of our common stock except pursuant to an effective registration statement under the Securities Act covering the resale of those shares, or an exemption under the Securities Act, including Rule 144.

Persons who may be deemed to be affiliates of LivePerson include those persons or entities who directly or indirectly control LivePerson, such as our directors, executive officers and significant stockholders.

OUR STOCK PRICE HAS BEEN HIGHLY VOLATILE AND MAY EXPERIENCE EXTREME PRICE AND VOLUME FLUCTUATIONS IN THE FUTURE WHICH COULD REDUCE THE VALUE OF YOUR INVESTMENT AND SUBJECT US TO LITIGATION.

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

- variations in our quarterly operating results;
- changes in market valuations of publicly-traded companies in general and Internet and other technology companies in particular;
- our announcements of significant client contracts, acquisitions and our ability to integrate these acquisitions, strategic partnerships, joint ventures or capital commitments;
- our failure to complete significant sales;
- additions or departures of key personnel;
- future sales of our common stock;
- changes in financial estimates by securities analysts; and
- terrorist attacks against the United States or in Israel, the engagement in hostilities or an escalation of hostilities by or against the United States or Israel, or the declaration of war or national emergency by the United States or Israel.

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

ANTI-TAKEOVER PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW MAY MAKE IT DIFFICULT FOR A THIRD PARTY TO ACQUIRE US.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Currency Rate Fluctuations

Through June 30, 2002, our results of operations, financial position and cash flows have not been materially affected by changes in the relative values of non-U.S. currencies to the U.S. dollar. The functional currency for our former operations in the United Kingdom is the U.K. pound (sterling) and the functional currency of our wholly-owned Israeli subsidiary, HumanClick Ltd., is the U.S. dollar. We do not use derivative financial instruments to limit our foreign currency risk exposure.

Collection Risk

Our accounts receivable are subject, in the normal course of business, to collection risks. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of collection risks. In the year ended December 31, 2001, we increased our allowance for doubtful accounts to approximately $1.5 million from $577,000 at December 31, 2000, principally due to an increase in accounts receivable and deteriorating aging due to slower collections. A significant portion of this increase was due to overdue accounts receivable balances for our Internet-related clients with limited operating histories, many of which began to face difficult business conditions in the past year, and, in particular, during the nine months ended September 30, 2001. During 2001, we wrote off approximately $1.3 million of previously reserved accounts, leaving an allowance of $160,000 at December 31, 2001. We did not increase our allowance for doubtful accounts in each of the three months ended June 30, 2002, March 31, 2002 and December 31, 2001. This is attributable to the fact that our accounts receivable collections improved in these periods, due primarily to the significantly larger percentage of our total outstanding accounts receivable now comprised of businesses with more established and proven operating histories, and to a lesser extent, to the fact that an increased number of our clients now pay us by credit card.

Interest Rate Risk

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On December 12, 2001, Compaq Financial Services Corporation, a subsidiary of Compaq Computer Corporation, filed a complaint against us in the Supreme Court of the State of New York, New York County. The complaint alleges that LivePerson is in default of an operating lease for computer equipment. Compaq is seeking to recover approximately $2.0 million in damages, fees and expenses. We have served an answer asserting affirmative defenses and counterclaims for fraud and negligent misrepresentation, and seek damages and fees. Compaq has moved for summary judgment on its claims, and we have filed papers in opposition to the motion. The motion is currently pending.

On November 16, 2001, Corio, Inc. filed a demand for arbitration against us with the American Arbitration Association in San Francisco County, California. The demand is related to a hosted software service contract terminated during 2001. Corio is seeking to recover approximately $1.4 million in damages, fees and expenses. We have filed an answer denying liability and asserting counterclaims for breach of contract and fraud, and seek a refund of all amounts paid to Corio, which equal approximately $1.5 million.

Although we intend to defend vigorously each of the matters described above, and believe that we have provided adequate reserves in connection with each of the claims, we cannot assure you that our defense in either case will be successful and, if it is not, that our ultimate liability in connection with either or both of these claims will not exceed our reserves or have a material adverse effect on our business, results of operations, financial condition, or cash flows.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

(d) Use of Proceeds from Registered Securities

On April 12, 2000, we consummated our initial public offering of 4,000,000 shares of common stock, for which trading on the Nasdaq National Market commenced on April 7, 2000, pursuant to the Registration Statement on Form S-1, file number 333¬95689, which was declared effective by the Securities and Exchange Commission on April 6, 2000. The managing underwriters of the offering were Chase Securities Inc., Thomas Weisel Partners LLC and PaineWebber Incorporated. The offering did not terminate until after the sale of all securities registered. The aggregate price of the offering shares was $32.0 million and our net proceeds were approximately $28.1 million after underwriters' discounts and commissions of approximately $2.2 million and other expenses of approximately $1.7 million. Except for salaries, and reimbursements for travel expenses and other out-of-pocket costs incurred in the ordinary course of business, none of the proceeds from the offering have been paid by us, directly or indirectly, to any of our directors or officers or any of their associates, or to any persons owning ten percent or more of our outstanding stock or to any of our affiliates. As of June 30, 2002, we have used approximately $17.7 million of the net proceeds from the offering for product development costs, sales and marketing activities and working capital and invested the remainder in cash and cash equivalents pending its use for other purposes.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our Annual Meeting of Stockholders on May 23, 2002.

The stockholders elected Steven Berns and Timothy E. Bixby as Class II directors, in each case for a three-year term expiring at the 2005 Annual Meeting of Stockholders and upon the election and qualification of his successor.

The stockholders approved separate proposals to amend our Fourth Amended and Restated Certificate of Incorporation to effect, alternatively, one of three different reverse splits of our issued and outstanding shares of common stock, at a ratio of one-for-three, one-for-five and one-for-seven. Pursuant to the authority granted by the proposals, our Board of Directors will have the discretion to decide which reverse split to implement, or not to effect a reverse split at all, at any time on or prior to September 16, 2002.

The stockholders ratified the appointment of KPMG LLP as our independent public accountants for the fiscal year ending December 31, 2002.

The votes were cast as follows:

Director Nominee or Proposal	For	Against / Withheld	Abstentions	Broker Non-Votes
Steven Berns	27,123,726	17,235	—	—
Timothy E. Bixby	27,123,726	17,235	—	—
One-for-Three Reverse Split	26,761,429	306,043	73,489	—
One-for-Five Reverse Split	26,596,139	402,137	142,685	—
One-for-Seven Reverse Split	26,636,014	427,747	77,200	—
Ratification of Accountants	26,948,676	104,885	87,400	—

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

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

99.1 Periodic Report Certification of Chief Executive Officer

99.2 Periodic Report Certification of Chief Financial Officer

(b) On May 17, 2002, we filed a current report on Form 8-K (Item 5), dated May 14, 2002, announcing that we had applied to The Nasdaq Stock Market, Inc. to transfer the listing of our common stock from the Nasdaq National Market to the Nasdaq SmallCap Market.

On May 24, 2002, we filed a current report on Form 8-K (Item 5), dated May 22, 2002, announcing that: (i) The Nasdaq Stock Market, Inc. notified LivePerson that Nasdaq had approved our application to transfer the listing of our common stock from the Nasdaq National Market to the Nasdaq SmallCap Market; and (ii) our stockholders had approved separate proposals to amend our Fourth Amended and Restated Certificate of Incorporation to effect, alternatively, one of three different reverse splits of our issued and outstanding shares of common stock, at a ratio of one-for-three, one-for-five and one-for-seven.

SIGNATURES

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

	LIVEPERSON, INC. (Registrant)	
Date: August 13, 2002	By:	/s/ ROBERT P. LOCASCIO
	Name:	Robert P. LoCascio
	Title:	Chief Executive Officer (duly authorized officer)
Date: August 13, 2002	By:	/s/ TIMOTHY E. BIXBY
	Name:	Timothy E. Bixby
	Title:	President, Chief Financial Officer and Secretary (principal financial and accounting officer)

EXHIBIT INDEX

EXHIBIT

99.1 Periodic Report Certification of Chief Executive Officer

99.2 Periodic Report Certification of Chief Financial Officer

EXHIBIT 99.1

PERIODIC REPORT CERTIFICATION
of
Chief Executive Officer

I, Robert P. LoCascio, Chief Executive Officer of LivePerson, Inc. (the “Company”), certify, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Quarterly Report of the Company on Form 10-Q for the quarterly period ended June 30, 2002, as filed with the Securities and Exchange Commission (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 13, 2002

/s/ ROBERT P. LOCASCIO
Robert P. LoCascio
Chief Executive Officer

EXHIBIT 99.2

PERIODIC REPORT CERTIFICATION
of
Chief Financial Officer

I, Timothy E. Bixby, Chief Financial Officer of LivePerson, Inc. (the “Company”), certify, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Quarterly Report of the Company on Form 10-Q for the quarterly period ended June 30, 2002, as filed with the Securities and Exchange Commission (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 13, 2002

/s/ TIMOTHY E. BIXBY
Timothy E. Bixby
President, Chief Financial Officer and Secretary