

SPARK NETWORKS INC  
Form 10-K  
March 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NO. 001-32750

SPARK NETWORKS, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	20-8901733
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11150 Santa Monica Boulevard, Suite 600,

Los Angeles, California	90025
(Address of principal executive offices)	(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (310) 893-0550

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SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, par value \$0.001 per share	NYSE MKT
Preferred Share Purchase Rights	NYSE MKT

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None.

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity (which consists solely of shares of common stock) held by non-affiliates of the registrant as of June 28, 2013 was approximately \$130,083,043 based on \$8.45, the closing price of the registrant's common stock on the NYSE MKT on June 28, 2013.

The registrant had 23,855,928 outstanding common stock, par value \$0.001 per share, as of March 13, 2014.

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Information required by Items 10, 11, 12, 13 and 14 of Part III are incorporated by reference from the Proxy Statement for the registrant's 2014 Annual Meeting of Stockholders. Except with respect to information specifically incorporated by reference in the Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

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SPARK NETWORKS, INC.

TABLE OF CONTENTS TO ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2013

ITEM	Page
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	4
Item 1A. <u>Risk Factors</u>	8
Item 1B. <u>Unresolved Staff Comments</u>	21
Item 2. <u>Properties</u>	21
Item 3. <u>Legal Proceedings</u>	22
Item 4. <u>Mine Safety Disclosures</u>	23
<b><u>PART II</u></b>	
Item 5. <u>Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	24
Item 6. <u>Selected Financial Data</u>	24
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	25
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	38
Item 8. <u>Financial Statements and Supplementary Data</u>	38
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	38
Item 9A. <u>Controls and Procedures</u>	38
Item 9B. <u>Other Information</u>	40
<b><u>PART III</u></b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	41
Item 11. <u>Executive Compensation</u>	41
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	41
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	41
Item 14. <u>Principal Accounting Fees and Services</u>	41
<b><u>PART IV</u></b>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	42
<u>Signatures</u>	45

Spark Networks and Spark Networks logos are trademarks and/or registered trademarks of Spark Networks USA, LLC, one of the Company’s indirect wholly owned subsidiaries.



## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K, including the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business,” contains forward-looking statements that involve substantial risks and uncertainties. All statements other than statements of historical facts contained in this annual report on Form 10-K, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as “believes,” “expects,” “anticipates,” “intends,” “estimates,” “may,” “will,” “continue,” “should,” “plan,” “predict,” “potential” or the negative of these terms or other similar expressions. We have based these forward-looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Our actual results could differ materially from those anticipated in these forward-looking statements, which are subject to a number of risks, uncertainties and assumptions described in the “Risk Factors” section and elsewhere in this annual report on Form 10-K, regarding, among other matters:

- our ability to attract members to our Web sites, convert members into paying subscribers and retain our paying subscribers;
- the highly competitive nature of our business;
- our ability to keep pace with rapid technological change and enhance existing or introduce new services;
- the strength of our existing brands and our ability to maintain and enhance those brands;
- our ability to effectively manage our operations and attract and retain qualified personnel;
- our dependence upon the telecommunications infrastructure and our networking hardware and software infrastructure; effectively protecting our internet and domain names and participating rights;
- the effect of new interpretation of existing laws and regulations on our operations;
- the volatility of the price of our equity securities; and
- other factors referenced in this annual report on Form 10-K and other reports.

You should not rely upon forward-looking statements as predictions of future events. We cannot assure you that the events and circumstances reflected in the forward-looking statements will be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. Except as required by law, we undertake no obligation to update publicly any forward-looking statements for any reason after the date of this annual report on Form 10-K to conform these statements to actual results or to changes in our expectations.

You should read this annual report on Form 10-K, and the documents that we reference in this annual report on Form 10-K and have filed as exhibits with the Securities and Exchange Commission, completely and with the understanding that our actual future results, levels of activity, performance and achievements may materially differ from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

## ADDITIONAL INFORMATION

We are required to file annual, quarterly and current reports, proxy statements and other information with the SEC. You can read our SEC filings over the Internet at the SEC’s Web site at <http://www.sec.gov>. You may also read and copy any document we file with the SEC at its public reference facilities at 100 F Street, N.E. Washington, DC 20549. You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities.

We maintain a corporate Web site at [www.spark.net](http://www.spark.net). You may access our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed with, or furnished to, the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, with the SEC free of charge at our Web site as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The reference to our Web address is provided for informational purposes only and does not constitute incorporation by reference of the information contained on this Web site.

## PART I

### ITEM 1. BUSINESS

Unless the context otherwise requires, the terms “Company,” “we,” “us,” and “our” refer to Spark Networks, Inc., a Delaware corporation and its subsidiaries. The Company was incorporated on April 20, 2007.

#### Our Business

We are a leading global media business, focused on creating iconic niche-focused brands that build and strengthen the communities they serve. Our core properties are primarily online singles desktop and mobile Web sites that enable adults to meet, participate in a community and form relationships with like-minded individuals. We provide this opportunity through many features on our Web sites, such as profiles, onsite email centers, real-time chat rooms, instant messaging services and, offline singles events.

Today, our largest and most recognizable Web sites are ChristianMingle.com and JDate.com. We also operate several international Web sites and maintain physical operations in both the United States and Israel. Information regarding the geographical source of our revenue and data on our four reportable segments can be found in Note 10 to our Consolidated Financial Statements included in this annual report.

Membership on our online singles Web sites is free and allows registered members to post personal profiles and access our searchable databases of member profiles. On most of our Web sites, the ability to initiate most communication with other members requires the payment of monthly subscription fees which, along with advertising sales on our online singles Web sites and media properties, represent our primary source of revenue. We typically offer discounted subscription rates to those members who subscribe for periods longer than one month. Subscriptions renew automatically until subscribers terminate them.

The common stock of Spark Networks, Inc. is traded on the NYSE MKT.

#### Our Industry

Our primary businesses are in the online personals industry, which we believe fulfills significant needs for single adults looking to meet a companion or date. Traditional methods such as printed personals advertisements, offline dating services and public gathering places often do not meet the needs of single people. Printed personals advertisements offer individuals limited personal information and interaction before meeting. Offline dating services are time-consuming, expensive and offer a smaller number of potential partners. Public gathering places such as restaurants, bars and other social venues provide a limited opportunity to learn about others prior to an in-person meeting. In contrast, online personals services facilitate interaction between singles by allowing them to screen and communicate with a large number of potential companions before they meet in-person. With features such as detailed personal profiles, email and instant messaging, this medium allows users to communicate with other singles at their convenience and affords them the ability to meet multiple people in an anonymous, convenient and secure online setting.

#### Our Competitive Strengths

**Strength of the ChristianMingle and JDate Brands.** We believe ChristianMingle and JDate, with their strong brand recognition, are valuable assets. We believe the size and strength of each of our key brands will allow us to market to and serve each of the Christian and Jewish communities profitably. Because of the strength of our brands, we believe



we are not required to spend as much on marketing them as we may on some of our lesser-known brands, or as much as others in the industry may spend on their personal Web sites.

**Affinity-Focused Communities.** We believe singles are more likely to interact, find friends and form lasting relationships with like-minded individuals who share common values, beliefs, traditions and cultural upbringings. For this reason, the majority of our Web sites are targeted to specific religious, ethnic, geographic and special interest groups. We believe our targeted communities enjoy greater word-of-mouth recognition and consumer loyalty relative to non-targeted communities.

**Web Site Functionality.** We continually evaluate the functionality of our Web sites to improve our members' experience. Many of the features we offer, such as onsite emails, real-time chat rooms, instant messaging, E-cards and message boards increase the probability of communication between our members, which we believe increases the number and percentage of members who become and remain paying subscribers.

4

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Customer Service Focus. Our multi-lingual call centers and email support team monitor our sites for fraudulent activity, assist members with billing questions, help members complete personal profiles and answer technical questions. We believe the quality of our customer service increases member satisfaction, which increases the number and percentage of members that become and remain paying subscribers.

Our Online Personals Services

Our online personals services offer single adults a convenient and secure setting for meeting other singles. Visitors to our Web sites are encouraged to become registered members and post profiles. Posting a profile is a process in which visitors are asked various questions about themselves, including information such as their tastes in food, hobbies and desired attributes of potential partners. Members may also post photos of themselves. Members can perform detailed searches of other profiles and save their preferences, and their profiles can be viewed by other members. In most cases, for a member to initiate email and instant message communication with others, that member must purchase a subscription. A subscription affords access to the paying subscribers' on-site email, instant messaging systems, message boards and chat rooms, enabling such subscribers to communicate with other members and paying subscribers. Our subscription fees are charged on a monthly basis, with discounts for longer-term subscription purchases.

Online Personals Web Site. We believe we are a relatively unique company in the online personals industry because we operate Web sites targeted at specific religious, ethnic, geographic and special interest groups. We currently offer Web sites primarily in English, Hebrew and French. Some of our Web sites, organized by segment, are as follows:

Online Personals Web Site	Target Audience
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Jewish Networks

JDate.com	Jewish singles
JDate.co.uk	Jewish singles
JDate.fr	Jewish singles (French speakers)
JDate.co.il	Jewish singles (Hebrew speakers)
Cupid.co.il	Jewish singles (Hebrew speakers)

Christian Networks

ChristianMingle.com	Christian singles
ChristianMingle.co.uk	Christian singles
ChristianMingle.com.au	Christian singles

Other Networks

AdventistSinglesConnection.com	Adventist singles Big beautiful women and admirers
BBWPersonalsPlus.com	African-American singles
BlackSingles.com	Catholic singles
CatholicMingle.com	Deaf singles
DeafSinglesConnection.com	Mormon singles
LDSMingle.com	Mormon singles
LDSSingles.com	Military singles
MilitarySinglesConnection.com	Mature singles
SilverSingles.com	Non-targeted
Spark.com	

Offline and Other Businesses

HurryDate.com	Rapid dating and offline events
Matchnet.com	Free dating search engine
Facelink.com	Free dating search engine

Web Site Features. We offer different ways for our members to communicate including:

On-Site Email. We provide all paying subscribers with private message centers. These personal on-site email boxes offer features such as customizable folders for storing correspondence, the ability to know when sent messages were read, as well as block and ignore functions, which allow paying subscribers to control future messages from specific paying subscribers.

5

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Hot Lists and Favorites. “Hot Lists” enable members to see who is interested in them and to save those favorite members in whom they are interested. Lists include (1) who has viewed your profile, (2) your favorites and (3) who has emailed you. Members can also group their favorites into customized folders and add their own notes, including details included in a member’s profile.

Message Boards. Message Boards enable paying subscribers to communicate in a group environment with suggested topics for discussion.

Real-Time Chat Rooms. Paying subscribers can use our exclusive chat rooms to mix and mingle in real-time, building a sense of community through group discussions. Additional features enable users to add customized graphics such as emoticons to their conversations.

Ice Breakers. Members can send pre-packaged opening remarks, referred to on the sites as “flirts” and “smiles,” to other members or paying subscribers.

Click! Our patented Click! feature connects members who think they would be compatible with each other. A member clicks “yes,” “no” or “maybe” in another member’s profile. When two members click “yes” in each other’s profiles, our patented feature sends an email to both of them alerting them of the match.

Travel and Events. As a complement to our online services, we offer travel and other promotional events which allow individuals to meet in a more personal environment. Our travel and events are typically weekend getaways, dinners, speed dating events or other mixers designed to facilitate social interaction.

Media Properties. We operate four different media properties primarily focused on serving the Christian community. These properties are designed to strengthen the Christian community and extend our relationship with our ChristianMingle users. Revenue generated from these properties today is driven by online advertising; however, we may develop other revenue streams on these or future complementary properties such as subscription services and hardgood sales. Our current portfolio of media properties include:

Media Property	Primary Content
Believe.com	Christian lifestyle portal
Faith.com	Inspirational videos
DailyBibleVerse.com	Send a daily bible verse
ChristianCard.net	Christian eCard and wallpaper site

### Business Strategy

We intend to grow revenue by driving additional traffic to our Web sites, increasing the number and percentage of our members who convert to paying subscribers, launching new or acquiring existing businesses, and expanding advertising sales on select Web sites.

Drive traffic. We believe there are opportunities to drive additional traffic to our Web sites through integrated and targeted marketing and cross-promotion into vertical affinity markets.

Integrated and targeted marketing. We believe targeting potential members with consistent and compelling marketing messages, delivered through a broad mix of marketing channels, will be effective in driving more traffic and a higher percentage of relationship-oriented singles to our Web sites. We intend to use a variety of channels to build our brands and increase our base of subscribers including online and offline advertising, customer relationship management tools, public relations, promotional alliances and special events.

Cross-promote. Our large base of members provides us with a significant amount of consumer data to evaluate cross-promotion opportunities for growth. We are able to analyze different groups of members by key metrics such as total potential subscribers and average revenue per paying subscriber and identify those targeted groups that may prefer a service dedicated to their particular affinity groups.

6

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Increase Conversion Rates. We believe a growth opportunity lies in our ability to convert more of our members into paying subscribers. We plan to achieve this increase in conversion by focusing on:

Improved member communications. We believe enhanced member communications is a key component to growing our business. We continue to focus on improving and enhancing our Web site functionality and features to encourage communications between members. Most of these communications require members to become paying subscribers. We will also continue to inform members of new features and functionality to increase the number of visitors to our Web sites who become paying subscribers.

Improved search. We believe the more successful members are in finding matches in our database, the more likely they are to want to communicate with those members and to refer their friends to our Web sites. To initiate email and instant message communication or participate in the chat rooms or message boards, members must become paying subscribers. We intend to continue to enhance the quality and relevance of our search results to provide faster, more relevant suggestions.

Leveraging strong customer service. Each time a member or a potential member contacts our customer service center by email or phone, he or she represents a potential new paying subscriber. By training our customer service representatives on upselling opportunities, we believe they will continue to be successful in selling our services.

Improve ad sales. We believe there is an opportunity for additional revenue from the sale of advertising on our Web sites. We expect advertisers will continue to seek highly targeted environments such as ours to complement their brands and reach niche consumers. We intend to remain selective about our choices for advertising partners so as not to adversely affect the quality of our user experience. In addition, we are uniquely able to offer advertisers not only online advertising but also an offline presence at our various parties and events around the country.

#### Sales and Marketing

We engage in a variety of marketing activities intended to drive consumer traffic to our Web sites and allow us the opportunity to introduce our products and services to prospective visitors, members and subscribers. Our marketing efforts are focused online and offline. Our online marketing approach employs a combination of banner and other display advertising. We also rely on search engine marketing and direct email campaigns to attract potential members and paying subscribers, and use a network of online affiliates, through which we acquire traffic.

We supplement our online marketing by employing a variety of offline marketing and business development activities. These include print, television, public relations, event sponsorship and promotional alliances. We believe a more consistent, targeted marketing message, delivered through an array of available marketing channels, will improve consumer awareness of our brands, drive more traffic to our Web sites and, therefore, increase the number of visitors, members and paying subscribers.

#### Customer Service

Our multi-lingual call centers and email support team monitor our sites for fraudulent activity, assist members with billing questions, help members complete personal profiles and answer technical questions. Customer service representatives receive ongoing training in an effort to better personalize the experience for members and paying subscribers who call or email us and to capitalize on upselling opportunities.

#### Technology

Throughout the year, projects, such as enhanced mobile services, were successfully deployed using a mix of our proprietary technologies. In addition to our new products, our technology employees maintain our software and hardware infrastructure.

Our network infrastructure and operations are designed to deliver high levels of availability, performance, security and scalability in a cost-effective manner. We operate Web and database servers co-located at third party data center facilities in Irvine, California and Bluffdale, Utah.

#### Intellectual Property

We rely on a combination of patent, trademark, copyright and trade secret laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brands. We also enter into confidentiality and invention assignment agreements with our employees and consultants and confidentiality agreements with other third parties.

7

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Spark Networks, Spark, ChristianMingle, JDate, and BlackSingles.com are some of our trademarks, whether registered or not, in the United States and several other countries. Spark Networks, Spark, ChristianMingle, JDate and BlackSingles.com are registered trademarks in the United States. Spark Networks, ChristianMingle and JDate are registered trademarks in the EU. ChristianMingle and JDate are registered trademarks in Australia. JDate is also a registered trademark in Israel and Canada. Our rights to these registered trademarks are perpetual as long as we use them and renew them periodically. We also have a number of other registered and unregistered trademarks. We hold two United States patents for our Click! technology, the first of which expires January 24, 2017, that pertain to an automated process for confidentially determining whether people feel mutual attraction or have mutual interests. Click! is important to our business in that it is a method and apparatus for detection of reciprocal interests or feelings and subsequent notification of such results. The patents describe the method and apparatus for the identification of a person's level of attraction and the subsequent notification when the feeling or attraction is mutual.

### Competition

We operate in a highly competitive environment with minimal barriers to entry. We believe the primary competitive factors in creating a community on the Internet are functionality, brand recognition, reputation, critical mass of members, member affinity and loyalty, ease-of-use, quality of service and reliability. We compete with a number of large and small companies, including vertically integrated Internet portals and specialty-focused media companies that provide online and offline products and services to the markets we serve. Our principal online personals services competitors include Match.com and OkCupid, two wholly-owned subsidiaries of InterActiveCorp, and eHarmony. In addition, we face competition from social networking sites such as Facebook.

### Government Regulation

Our business is regulated by diverse and evolving laws and governmental authorities in the United States and other countries in which we operate. We are subject to laws and regulations related to Internet communications, security, privacy, consumer protection, security and data protection, intellectual property rights, advertising, commerce, taxation, entertainment, recruiting and advertising. These laws and regulations are becoming more prevalent, and new laws and regulations are under consideration by the United States Congress, state legislatures and foreign governments. Any failure by us to comply with existing laws and regulations may subject us to liabilities. New laws and regulations governing such matters could be enacted or amendments may be made to existing regulations at any time that could adversely impact our services. Plus, legal uncertainties surrounding domestic and foreign government regulations could increase our costs of doing business, require us to revise our services, prevent us from delivering our services over the Internet or slow the growth of the Internet, any of which could materially adversely affect our business, financial condition and results of operations.

### Employees

As of December 31, 2013, we had 201 full-time equivalent employees. We are not subject to any collective bargaining agreements and we believe our relationship with our employees is good.

## ITEM 1A. RISK FACTORS

You should carefully consider the risks described below together with all of the other information included in this report before making an investment decision. The risks described below are the material risks that we are currently aware of that are facing our company. In addition, other sections of this report may include additional factors that could adversely impact our business and operating results. If any of the following risks actually occurs, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our



common stock could decline and you may lose all or part of your investment.

#### Risks Related to Our Business

Our growth rates may decline and our operating margins could deteriorate; our business, financial condition and results of operations may be adversely affected by a slowdown or contraction in the economy.

Between 2007 and 2010, our revenue declined and it may decline again in the future. It is possible our operating margins will deteriorate if revenue growth does not exceed planned increases in expenditures for all aspects of our business in an increasingly competitive environment, including sales and marketing, development, technical operations and general and administrative expenses.

8

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Our member and paying subscriber base is composed of individual consumers and in the event of a continued prolonged economic downturn in the United States or in our international markets in which spending by individual consumers drops significantly, our current and potential subscribers may be unable or unwilling to subscribe to our services and our business may be negatively affected. In addition, the current or future tightening of credit in financial markets could result in a decrease in demand for our products and services if subscribers do not have access to credit. To the extent the overall economy continues to deteriorate or does not improve, we may lose existing members and paying subscribers and fail to attract new members and paying subscribers, which could adversely affect our business, financial condition and results of operations.

We have significant operating losses and we may incur additional losses in the future.

We have historically generated significant operating losses in some years. As of December 31, 2013, we had an accumulated deficit of approximately \$56.4 million. We had net loss of approximately (\$12.4), (\$15.0) and (\$1.6) million for the years ended December 31, 2013, 2012 and 2011, respectively. If our revenue does not grow at a substantially faster rate than our operating expenses, or if our operating expenses are higher than we anticipate, or if our revenue begins to decline but our operating expenses increase, we may not be profitable and we may incur additional losses, which could be significant.

Adverse capital and credit market conditions could limit our access to capital and increase our cost of capital, which may significantly affect our ability to meet liquidity needs.

The capital and credit markets have been experiencing extreme volatility over the last few years. In some cases, the markets have exerted downward pressure on availability of liquidity and credit capacity for certain issuers. Without sufficient liquidity, we may be forced to curtail certain operations and may be unable to operate our business as we deem appropriate. Disruptions, uncertainty or volatility in the capital and credit markets may also limit our access to capital required to operate our business. Such market conditions may limit our ability to replace, in a timely manner, maturing liabilities and access the capital necessary to operate and grow our business. As such, we may be forced to delay raising capital or bear an unattractive cost of capital which could decrease our profitability and significantly reduce our financial flexibility. Our results of operations, financial condition, cash flows and capital position could be materially adversely affected by disruptions in the financial markets.

If our efforts to attract a large number of members, convert members into paying subscribers and retain our paying subscribers are not successful, our revenue and operating results will suffer.

Our future growth depends on our ability to attract a large number of members, convert members into paying subscribers and retain our paying subscribers. This in turn depends on our ability to deliver a high-quality online personals experience to these members and paying subscribers. As a result, we must continue to invest significant resources in order to enhance our existing products and services and introduce new high-quality products and services that people will use. If we are unable to predict user preferences or industry changes, or if we are unable to modify our products and services on a timely basis, we may lose existing members and paying subscribers and may fail to attract new members and paying subscribers. Our revenue and expenses will also be adversely affected if our innovations are not responsive to the needs of our members and paying subscribers or are not brought to market in an effective or timely manner.

We need to maintain or increase our number of average paying subscribers to maintain or increase our current level of revenue.

The majority of our revenue is generated by internet users that pay us a subscription fee. One of our key performance metrics focuses on the average number of paying subscribers in a given period. The number of monthly average

paying subscribers is calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in the period. Internet users, in general, and users of online personals services specifically, freely navigate and use the services offered by a variety of Web sites. We cannot assure you that our monthly average paying subscriber numbers will remain at consistent levels, and they may decrease in the future, thus decreasing our revenue. In 2013, average paying subscribers increased 14.8% and revenue also increased 12.4% compared to 2012. If we do not constantly attract new paying subscribers at a faster rate than subscription terminations, our average paying subscribers will decrease and we will not be able to maintain or increase our current level of revenue.

Our subscriber acquisition costs vary depending upon prevailing market conditions and may increase significantly in the future.

Costs for us to acquire paying subscribers are dependent, in part, upon our ability to purchase advertising at a reasonable cost. Our advertising costs vary over time, depending upon a number of factors, many of which are beyond our control. Historically, we have used online and offline advertising as the primary means of marketing our services. During 2013, our cost of revenue substantially increased, primarily as a result of higher direct marketing expenses related to our Christian Networks.

Despite a slow economy, costs of online and/or offline advertising may continue to increase. If we are not able to reduce our other operating costs, increase our paying subscriber base or increase revenue per paying subscriber to offset these increases, our profitability will be adversely affected.

In addition, our costs to acquire subscribers may increase if we raise prices on our Web sites as potential customers may be slower or more reluctant to purchase higher-priced services.

We secured a \$15.0 million revolving credit facility, which could restrict our ability to use our operating cash flow for the growth of our business.

In February 2008, we entered into an initial credit agreement with Bank of America under which we had no outstanding borrowings as of December 31, 2013. If we are unable to pay our debts as they become due, we will be required to pursue one or more alternative strategies, such as refinancing or restructuring our indebtedness, selling additional debt or equity securities or selling assets. We may not be able to refinance our debt or issue additional debt or equity securities on favorable terms, if at all, and if we must sell our assets, it may negatively affect our ability to generate future revenue. If we are unable to meet our obligations as they become due or to comply with various financial covenants contained in the revolving credit facility, this could constitute an event of default.

Our obligations under the credit facility are secured by a lien on substantially all of the assets of Spark Networks USA, LLC, which is the borrower under the credit facility, and by guarantees by Spark Networks, Inc. and a number of our subsidiaries. Any default under the credit facility, could result in an acceleration of payment of all outstanding debt owed at the time, which could materially and adversely affect our financial condition.

Our revolving credit facility has certain covenants that could restrict how we operate our business.

The terms of our revolving credit facility contain various provisions that limit our ability to, among other things:

- incur or guarantee additional debt;
- receive dividends or distributions from our subsidiaries;
- make investments and other restricted payments;
- make dividend payments or redeem equity securities;
- grant liens;
- transfer or sell assets;
- engage in different lines of business; and
- consolidate, merge or transfer all or substantially all of our assets.

These covenants may affect our ability to operate and finance our business as we deem appropriate. If we are unable to meet our obligations as they become due or to comply with various financial covenants contained in the revolving credit facility, this could constitute an event of default.

Competition presents an ongoing threat to the performance of our business.

We expect competition in the online personals business to continue to increase because there are no substantial barriers to entry. We believe our ability to compete depends upon many factors both within and beyond our control, including the following:

- the size and diversity of our member and paying subscriber bases;
- the timing and market acceptance of our products and services, including the developments and enhancements to those products and services relative to those offered by our competitors;
- customer service and support efforts;

10

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selling and marketing efforts; and  
our brand strength in the marketplace relative to our competitors.

We compete with traditional personals services, as well as newspapers, magazines and other traditional media companies that provide personals services. We compete with a number of large and small companies, including Internet portals and specialty-focused media companies that provide online and offline products and services to the markets we serve. Our principal online personals services competitors include Match.com and OkCupid, two wholly-owned subsidiaries of InterActiveCorp and eHarmony. In addition, we face competition from social networking Web sites such as Facebook. Many of our current and potential competitors have longer operating histories, significantly greater financial, technical, marketing and other resources and larger customer bases than we do. These factors may allow our competitors to respond more quickly than we can to new or emerging technologies and changes in customer requirements. These competitors may engage in more extensive research and development efforts, undertake more far-reaching marketing campaigns and adopt more aggressive pricing policies that may allow them to build larger member and paying subscriber bases than ours. Our competitors may develop products or services that are equal or superior to our products and services or that achieve greater market acceptance than our products and services. These activities could attract members and paying subscribers away from our Web sites and reduce our market share.

In addition, current and potential competitors are making, and are expected to continue to make, strategic acquisitions or establishing cooperative and, in some cases, exclusive relationships with significant companies or competitors to expand their businesses or to offer more comprehensive products and services. To the extent these competitors or potential competitors establish exclusive relationships with major portals, search engines and Internet Service Providers, or ISPs, our ability to reach potential members through online advertising may be restricted. Any of these competitors could cause us difficulty in attracting and retaining members and converting members into paying subscribers and could jeopardize our existing affiliate program and relationships with portals, search engines, ISPs and other Web properties.

Our efforts to capitalize upon opportunities to expand into new vertical affinity markets may fail and could result in a loss of capital and other valuable resources.

We may decide to expand into new vertical affinity markets to increase our revenue base. If we expand into such vertical affinity markets, management's time and attention will be less focused on our existing businesses and will require us to invest significant capital resources. The results of any expansion efforts into new vertical affinity markets are unpredictable, and there is no guarantee that our efforts will have a positive effect on our revenue base. We face many risks associated with our planned expansion into new vertical affinity markets, including but not limited to the following:

- competition from pre-existing competitors with significantly stronger brand recognition in the markets we enter;
- our improper evaluation of the potential of such markets;
- diversion of capital and other valuable resources away from our core business;
- foregoing opportunities that are potentially more profitable; and
- weakening our current brands by over expansion into too many new markets.

If we fail to keep pace with rapid technological change, our competitive position will suffer.

We operate in a market characterized by rapidly changing technologies, evolving industry standards, frequent new product and service announcements, enhancements and changing customer demands. Accordingly, our performance will depend on our ability to adapt to rapidly changing technologies and industry standards, and our ability to continually improve the speed, performance, features, ease of use and reliability of our services in response to both evolving demands of the marketplace and competitive service and product offerings. There have been occasions when we have not been as responsive as many of our competitors in adapting our services to changing industry standards

and the needs of our members and paying subscribers. Our industry has been subject to constant innovation and competition. New features may be introduced by one competitor, and if they are perceived as attractive to users, they are often copied later by others. Over the last few years, such new feature introductions in the industry have included instant messaging, message boards, E-cards, personality profiles and mobile content delivery. Introducing new technologies into our systems involves numerous technical challenges, substantial amounts of capital and personnel resources and often takes many months to complete. We intend to continue to devote efforts and funds toward the development of additional technologies and services. For example, in 2013 and 2012 we introduced a number of new features, and we anticipate the introduction of additional features in 2014 and 2015. We may not be able to effectively integrate new technologies into our Web sites on a timely basis or at all, which may degrade the responsiveness and speed of our Web sites. Such technologies, even if integrated, may not function as expected.

Our business depends on establishing and maintaining strong brands and if we are not able to maintain and enhance our brands, we may be unable to expand or maintain our member and paying subscriber bases.

We believe that establishing and maintaining our brands is critical to our efforts to attract and expand our member and paying subscriber bases. We believe that the importance of brand recognition will continue to increase, given the growing number of Internet sites and the low barriers to entry for companies offering online personals services. To attract and retain members and paying subscribers, and to promote and maintain our brands in response to competitive pressures, we may have to substantially increase our financial commitment to creating and maintaining distinct brand loyalty among these groups. If visitors, members and paying subscribers to our Web sites and our affiliate and distribution associates do not perceive our existing services to be of high quality, or if we introduce new services or enter into new business ventures that are not favorably received by such parties, the value of our brands could be diluted, thereby decreasing the attractiveness of our Web sites to such parties. As a result, our results of operations may be adversely affected by decreased brand recognition.

If we are unable to attract, retain and motivate key personnel or hire qualified personnel, or such personnel do not work well together, our growth prospects and profitability will be harmed.

Our performance is largely dependent on the talents and efforts of highly skilled individuals. The loss of any of our management or key personnel could seriously harm our business.

We may also encounter difficulties in recruiting personnel as we become a more mature company in a competitive industry. Competition in our industry for personnel is intense, and we are aware that our competitors have directly targeted our employees. We do not have non-competition agreements with most employees and, even in cases where we do, these agreements are of limited enforceability in California. We also do not maintain any key-person life insurance policies on our executives. The incentives to attract, retain and motivate employees provided by our option grants or by future arrangements, such as cash bonuses, may not be as effective as they have been in the past. If we do not succeed in attracting necessary personnel or retaining and motivating existing personnel, we may be unable to grow effectively.

Our business depends on our server and network hardware and software and our ability to obtain network capacity; our current safeguard systems may be inadequate to prevent an interruption in the availability of our services.

The performance of our server and networking hardware and software infrastructure is critical to our business and reputation, to our ability to attract visitors and members to our Web sites, to convert them into paying subscribers and to retain paying subscribers. An unexpected and/or substantial increase in the use of our Web sites could strain the capacity of our systems, which could lead to a slower response time or system failures. Although we have not recently experienced any significant delays, any future slowdowns or system failures could adversely affect the speed and responsiveness of our Web sites and would diminish the experience for our visitors, members and paying subscribers. We face risks related to our ability to scale up to potential increased customer levels while maintaining superior performance. If the usage of our Web sites substantially increases, we may need to purchase additional servers and networking equipment and services to maintain adequate data transmission speeds, the availability of which may be limited or the cost of which may be significant. Any system failure that causes an interruption in service or a decrease in the responsiveness of our Web sites could reduce traffic on our Web sites and, if sustained or repeated, could impair our reputation and the attractiveness of our brands as well as reduce revenue and negatively impact our operating results.

Furthermore, we rely on many different hardware systems and software applications, some of which have been developed internally. If these hardware systems or software applications fail, it would adversely affect our ability to provide our services. If we are unable to protect our data from loss or electronic or magnetic corruption, or if we



receive a significant unexpected increase in usage and are not able to rapidly expand our transaction-processing systems and network infrastructure without any systems interruptions, it could seriously harm our business and reputation. We have experienced occasional systems interruptions in the past as a result of unexpected increases in usage, and we cannot assure you that we will not incur similar or more serious interruptions in the future. From time to time, our company and our Web sites may be subject to delays and interruptions due to software viruses, or variants thereof, such as internet worms.

In addition, we do not have a “high availability” disaster recovery system, which means in the event of any catastrophic failure involving our Web sites, we may be unable to serve our Web traffic for a significant period of time. Our Web sites primarily operate from only a single site located in either Southern California or Utah. Any system failure, including network, software or hardware failure, that causes an interruption in the delivery of our Web sites and services or a decrease in responsiveness of our services would result in reduced visitor traffic, reduced revenue and would adversely affect our reputation and brands.

The failure to establish and maintain affiliate agreements and relationships could limit the growth of our business.

We have entered into, and expect to continue to enter into, arrangements with affiliates to increase our member and paying subscriber bases, bring traffic to our Web sites and enhance our brands. Pursuant to our arrangements, an affiliate generally advertises or promotes one or more of our Web sites on its Web site, and earns a fee whenever visitors to its Web site click through the advertisement to one of our Web sites and register or subscribe to one of our Web sites. These affiliate arrangements are easily cancelable, often with one day notice. We do not typically have any exclusivity arrangements with our affiliates, and some of our affiliates may also be affiliates for our competitors. None of these affiliates, individually, represents a material portion of our revenue. If any of our current affiliate agreements are terminated, we may not be able to replace the terminated agreement with an equally beneficial arrangement. We cannot assure you that we will be able to renew any of our current agreements when they terminate or, if we are able to do so, that such renewals will be available on acceptable terms. We also do not know whether we will be able to enter into additional agreements or that any relationships, if entered into, will be on terms favorable to us.

We rely on a number of third-party providers and their failure or unwillingness to continue to perform could harm us.

We rely on third parties to provide important services and technologies to us, including third parties that manage and monitor our offsite data centers located in Southern California and Utah, ISPs, search engine marketing providers and credit card processors. In addition, we license technologies from third parties to facilitate our ability to provide our services. Any failure on our part to comply with the terms of these licenses could result in the loss of our rights to continue using the licensed technology, and we could experience difficulties obtaining licenses for alternative technologies. Furthermore, any failure of these third parties to provide these and other services, or errors, failures, interruptions or delays associated with licensed technologies, could significantly harm our business. Any financial or other difficulties our providers face may have negative effects on our business, the nature and extent of which we cannot predict. Except to the extent of the terms of our contracts with such third party providers, we exercise little or no control over them, which increases our vulnerability to problems with the services and technologies they provide and license to us. In addition, if any fees charged by third-party providers were to substantially increase, such as if ISPs began charging us for emails sent by our paying subscribers to other members or paying subscribers, we could incur significant additional losses.

We may not be effective in protecting our Internet domain names or proprietary rights upon which our business relies or in avoiding claims that we infringe upon the proprietary rights of others.

We regard substantial elements of our Web sites and the underlying technology as proprietary, and attempt to protect them by relying on trademark, service mark, copyright, patent and trade secret laws and restrictions on disclosure and transferring title and other methods. We also generally enter into confidentiality agreements with our employees and consultants, and generally seek to control access to and distribution of our technology, documentation and other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our proprietary information without authorization or to develop similar or superior technology independently. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our services are distributed or made available through the Internet, and policing unauthorized use of our proprietary information is difficult. Any such misappropriation or development of similar or superior technology by third parties could adversely impact our profitability and our future financial results.

We believe that our Web sites, services, trademarks, patent and other proprietary technologies do not infringe upon the rights of third parties. However, there can be no assurance that our business activities do not and will not infringe upon the proprietary rights of others, or that other parties will not assert infringement claims against us. We are aware that other parties utilize the “Spark” name, or other marks that incorporate it, and those parties may have rights to such marks that are superior to ours. From time to time, we have been, and expect to continue to be, subject to claims in the

ordinary course of business including claims of alleged infringement of the trademarks, service marks and other intellectual property rights of third parties by us. Although such claims have not resulted in any significant litigation or had a material adverse effect on our business to date, any such claims and resultant litigation might subject us to temporary injunctive restrictions on the use of our products, services or brand names and could result in significant liability for damages for intellectual property infringement, require us to enter into royalty agreements, or restrict us from using infringing software, services, trademarks, patents or technologies in the future. Even if not meritorious, such litigation could be time-consuming and expensive and could result in the diversion of management's time and attention away from our day-to-day business.

We currently hold various Web domain names related to our brands and in the future may acquire new Web domain names. The regulation of domain names in the United States and in foreign countries is subject to change. Governing bodies may establish additional top level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names in all countries in which we conduct business. Furthermore, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our existing trademarks and other proprietary rights or those we may seek to acquire. Any such inability to protect ourselves could cause us to lose a significant portion of our members and paying subscribers to our competitors.

We may face potential liability, loss of users and damage to our reputation for violation of our privacy policy or privacy laws and regulations or be required to change our business practices in an adverse manner.

Our privacy policy prohibits the sale or disclosure to any third party of any member's personal identifying information, except to the extent expressly set forth in the policy. Growing public concern about privacy and the collection, distribution and use of information about individuals may subject us to increased regulatory scrutiny and/or litigation. In the past, the Federal Trade Commission has investigated companies that have used personally identifiable information without permission or in violation of a stated privacy policy. If we are accused of violating the stated terms of our privacy policy, we may be forced to expend significant amounts of financial and managerial resources to defend against these accusations and we may face potential liability. Our membership database holds confidential information concerning our members, and we could be sued if any of that information is misappropriated or if a court determines that we have failed to protect that information.

In addition, our affiliates handle personally identifiable information pertaining to our members and paying subscribers. Both we and our affiliates are subject to laws and regulations related to Internet communications, consumer protection, advertising, privacy, security and data protection. For example, we are subject to the CAN-SPAM Act of 2003, California's Information Practice Act, which requires notification to users when there is a security breach of personal data, and other state regulations that impose additional requirements on data protection, such as the requirement to encrypt data sent over the internet. If we or our affiliates are found to be in violation of these laws and regulations, we may become subject to administrative fines or litigation or be required to change our data practices, which could materially increase our expenses, adversely affect our results of operations and cause the value of our securities to decline.

Proposed legislation concerning data protection is currently pending at the U.S federal and state level as well as in certain foreign jurisdiction. In addition, the interpretation and application of data protection laws in Europe, the United States and elsewhere are still uncertain. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have an adverse effect on our business. Complying with these laws as they evolve could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

We may be liable as a result of information retrieved from or transmitted over the Internet.

We may be sued for defamation, civil rights infringement, negligence, copyright or trademark infringement, invasion of privacy, personal injury, product liability or under other legal theories relating to information that is published or made available on our Web sites and the other sites linked to it. These types of claims have been brought, sometimes successfully, against online services in the past. We also offer messaging services on our Web sites and send emails directly and through third parties, which may subject us to potential risks, such as liabilities or claims resulting from unsolicited email or spamming, lost or misdirected messages, security breaches, illegal or fraudulent use of email or personal information or interruptions or delays in email service. Our insurance does not specifically provide for coverage of these types of claims and, therefore, may be inadequate to protect us against them. In addition, we could incur significant costs in investigating and defending such claims, even if we ultimately are not held liable. If any of these events occurs, our revenue could be materially adversely affected or we could incur significant additional expense, and the market price of our securities may decline.

Our quarterly results may fluctuate because of many factors and, as a result, investors should not rely on quarterly operating results as indicative of future results.

Fluctuations in operating results or the failure of operating results to meet the expectations of public market analysts and investors may negatively impact the value of our common stock. Quarterly operating results may fluctuate in the future due to a variety of factors that could affect revenue or expenses in any particular quarter. Fluctuations in quarterly operating results could cause the value of our securities to decline. Investors should not rely on quarter-to-quarter comparisons of results of operations as an indication of future performance. Factors that may affect our quarterly results include:

- the demand for, and acceptance of, our online personals services and enhancements to these services;
- the timing and amount of our subscription revenue;
- the introduction, development, timing, competitive pricing and market acceptance of our Web sites and services and those of our competitors;
- the magnitude and timing of marketing initiatives and capital expenditures relating to expansion of our operations;
- the cost and timing of online and offline advertising and other marketing efforts;

14

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the maintenance and development of relationships with portals, search engines, ISPs and other Web properties and other entities capable of attracting potential members and paying subscribers to our Web sites; technical difficulties, system failures, system security breaches, or downtime of the Internet, in general, or of our products and services, in particular; costs related to any acquisitions or dispositions of technologies or businesses; fluctuations in foreign exchange rates; and general economic conditions, as well as those specific to the Internet, online personals and related industries. As a result of the factors listed above and because the online personals business is still immature, making it difficult to predict consumer demand, it is possible that in future periods results of operations may be below the expectations of public market analysts and investors. This could cause the market price of our securities to decline.

We may need additional capital to finance our growth or to compete, which may cause dilution to existing stockholders or limit our flexibility in conducting our business activities.

We currently anticipate that existing cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated needs for working capital, operating expenses and capital expenditures for at least the next twelve months. However, we may need to raise additional capital in the future to fund expansion, whether in new vertical affinity or geographic markets, develop newer or enhanced services, respond to competitive pressures or acquire complementary businesses, technologies or services. Such additional financing may not be available on terms acceptable to us or at all. To the extent that we raise additional capital by issuing equity securities, our stockholders may experience substantial dilution, and to the extent we engage in additional debt financing, if available, we may become subject to additional restrictive covenants that could limit our flexibility in conducting future business activities. If additional financing is not available or not available on acceptable terms, we may not be able to fund our expansion, promote our brands, take advantage of acquisition opportunities, develop or enhance services or respond to competitive pressures.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders could lose confidence in our financial reporting, which would harm the value of our stock.

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports, effectively prevent fraud and operate as a public company. We are required to report on an annual basis on the effectiveness of our internal controls over financial reporting, and as an accelerated filer, our auditors provide an attestation report. We have, in the past, discovered and may, in the future, discover areas of our internal controls over financial reporting that need improvement. If we are unable to adequately maintain or improve our internal controls over financial reporting, we may report that our internal controls are ineffective. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. Ineffective internal controls over financial reporting could also cause investors to lose confidence in our reported financial information which would likely have a negative effect on the trading price of our securities or could affect our ability to access the capital markets and which could result in regulatory proceedings against us by, among others, the U.S. Securities Exchange Commission.

Acquisitions could result in operating difficulties, dilution and other harmful consequences.

We have historically and may in the future further extend and develop our presence, both within the United States and internationally, partially through acquisitions of entities offering online personals services and related businesses. We have relatively limited experience acquiring companies and the companies we have acquired have been small. We have evaluated, and continue to evaluate, a wide array of potential strategic transactions. From time to time, we may engage in discussions regarding potential acquisitions, some of which may divert significant resources away from our daily operations. In addition, the process of integrating an acquired company, business or technology is risky and may

create unforeseen operating difficulties and expenditures. Some areas where we may face risks include:

the need to implement or remediate controls, procedures and policies of acquired companies that lacked appropriate controls, procedures and policies prior to the acquisition;  
diversion of management time and focus from operating our business to acquisition integration challenges;  
cultural challenges associated with integrating employees from an acquired company into our organization;  
retaining employees from the businesses we acquire; and  
the need to integrate each company's accounting, management information, human resources and other administrative systems to permit effective management.

15

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The anticipated benefit of many of our acquisitions may not materialize. Future acquisitions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, or write-offs, any of which could harm our financial condition. Future acquisitions may require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all.

Our limited experience outside the United States increases the risk that any international expansion efforts and operations will not be effective.

One of our strategies is to expand our presence in international markets. Although we currently have offices in Israel and Web sites that directly serve the French, Israeli and United Kingdom markets, we have only limited experience with operations outside the United States. Our primary international operations are in Israel, which carries additional risk for our business as a result of continuing hostilities there. Expansion into international markets requires management time and capital resources. In addition, we face the following additional risks associated with our expansion outside the United States:

- challenges caused by distance, language and cultural differences;
- local competitors with substantially greater brand recognition, more users and more traffic than we have;
- our need to create and increase our brand recognition and improve our marketing efforts internationally and build strong relationships with local affiliates;
- longer payment cycles in some countries;
- credit risk and higher levels of payment fraud in some countries;
- different legal and regulatory restrictions among jurisdictions;
- political, social and economic instability;
- potentially adverse tax consequences; and
- higher costs associated with doing business internationally.

Our international operations subject us to risks associated with currency fluctuations.

Our foreign operations may subject us to currency fluctuations and such fluctuations may adversely affect our financial position and results. However, sales and expenses to date have occurred primarily in the United States. For this reason, we have not engaged in foreign exchange hedging. Currency risk positions could change correspondingly and the use of foreign exchange hedging instruments could become necessary. Effects of exchange rate fluctuations on our financial condition, operations and profitability may depend on our ability to manage our foreign currency risks. There can be no assurance that steps taken by management to address foreign currency fluctuations will eliminate all adverse effects and, accordingly, we may suffer losses due to adverse foreign currency fluctuation.

Our business could be significantly impacted by the occurrence of natural disasters and other catastrophic events.

Our operations depend upon our ability to maintain and protect our network infrastructure, hardware systems and software applications, which are housed primarily at data centers located in Southern California and Utah that are managed by third parties. Our business is therefore susceptible to earthquakes, tsunamis and other catastrophic events, including acts of terrorism. We currently do not possess a “high availability” disaster recovery system. As a result, outages and downtime caused by natural disasters and other events out of our control, which affect our systems or data centers, could adversely affect our reputation, brands and business.

We hold a fixed amount of insurance coverage, and if we were found liable for an uninsured claim, or claim in excess of our insurance limits, we may be forced to expend significant capital to resolve the uninsured claim.

We contract for a fixed amount of insurance to cover potential risks and liabilities, including, but not limited to, property and casualty insurance, general liability insurance and errors and omissions liability insurance. If we decide



to pursue obtaining additional insurance coverage in the future, it is possible that (1) we may not be able to get enough insurance to meet our needs; (2) we may have to pay very high premiums for the additional coverage; (3) we may not be able to acquire any insurance for certain types of business risk; or (4) we may have gaps in coverage for certain risks. This could leave us exposed to potential uninsured claims for which we could have to expend significant amounts of capital resources. Consequently, if we were found liable for a significant uninsured claim in the future, we may be forced to expend a significant amount of our operating capital to resolve the uninsured claim.

Our services may not be well-suited to many alternate Web access devices, and as a result the growth of our business could be negatively affected.

The number of people who access the Internet through devices other than desktop and laptop computers, including mobile telephones, tablets, and other handheld computing devices, has increased dramatically in the past several years, and we expect this growth to continue. The smaller screen and keyboard sizes and reduced functionality currently associated with such devices may make the use of our services through such devices more difficult and generally impairs the member experience relative to access via desktop and laptop computers. If we are unable to attract and retain a substantial number of such device users to our online personals services or if we are unable to develop services that are more compatible with such devices in a timely fashion, our growth could be adversely affected.

#### Risks Related to Our Industry

Our network is vulnerable to security breaches and inappropriate use by Internet users, which could disrupt or deter future use of our services.

Concerns over the security of transactions conducted on the Internet and the privacy of users may inhibit the growth of the Internet and other online services generally, and online commerce services, like ours, in particular. To date, we have not experienced any material breach of our security systems; however, a failure on our part to effectively prevent security breaches could significantly harm our business, reputation and results of operations and could expose us to lawsuits by state and federal consumer protection agencies, by governmental authorities in the jurisdictions in which we operate, and by consumers. Anyone who is able to circumvent our security measures could misappropriate proprietary information, including customer credit card and personal data, cause interruptions in our operations or damage our brand and reputation. Such breach of our security measures could involve the disclosure of personally identifiable information and could expose us to a material risk of litigation, liability or governmental enforcement proceeding. We cannot assure you that our financial systems and other technology resources are completely secure from security breaches or sabotage, and we have occasionally experienced security breaches and attempts at “hacking.” We may be required to incur significant additional costs to protect against security breaches or to alleviate problems caused by such breaches. Any well-publicized compromise of our security or the security of any other Internet provider could deter people from using our services or the Internet to conduct transactions that involve transmitting confidential information or downloading sensitive materials, which could have a detrimental impact on our existing and potential customer base.

Computer viruses may cause delays or other service interruptions and could damage our reputation, affect our ability to provide our services and adversely affect our revenue. The inadvertent transmission of computer viruses could also expose us to a material risk of loss or litigation and possible liability. Moreover, if a computer virus affecting our system were highly publicized, our reputation could be significantly damaged, resulting in the loss of current and future members and paying subscribers.

We face certain risks related to the physical and emotional safety of our members and paying subscribers.

The nature of online personals services is such that we cannot control the actions of our members and paying subscribers in their communication or physical actions. There is a possibility that one or more of our members or paying subscribers could be physically or emotionally harmed following interaction with another one of our members or paying subscribers. We warn our members and paying subscribers that we do not conduct background checks on other members and paying subscribers and, given our lack of physical presence, we do not take any action to ensure personal safety on a meeting between members or paying subscribers arranged following contact initiated via our Web sites. If an unfortunate incident of this nature occurred in a meeting of two people following contact initiated on one of our Web sites or a Web site of one of our competitors, any resulting negative publicity could materially and adversely

affect us or the online personals industry in general. Any such incident involving one of our Web sites could damage our reputation and our brands. This, in turn, could adversely affect our revenue and could cause the value of our common stock to decline. In addition, the affected members or paying subscribers could initiate legal action against us, which could cause us to incur significant expense, whether we were successful or not, and damage our reputation.

We are or may be subject to litigation and regulatory actions that may distract management and could have a material adverse effect on our financial condition and results of operations.

We are or have been a party to various litigation claims and legal proceedings, including purported class action lawsuits and litigation involving our business operations and intellectual property. We may also be subject to regulatory actions and litigation based on our business operations. For example, we supply online personals services and in many jurisdictions, companies deemed dating service providers are subject to additional regulation, while companies that provide personals services are not generally subject to similar regulation. Because personals services and dating services can seem similar, we are exposed to potential litigation, including class action lawsuits, associated with providing our personals services. In the past, a small percentage of our members have alleged that we are a dating service provider, and, as a result, they claim that we are required to comply with regulations that include, but are not limited to, providing language in our contracts that may allow members to (1) rescind their contracts within a certain period of time, (2) demand reimbursement of a portion of the contract price if the member dies during the term of the contract and/or (3) cancel their contracts in the event of disability or relocation. If a court holds that we have provided and are providing dating services of the type the dating services regulations are intended to regulate, we may be required to comply with regulations associated with the dating services industry and be liable for any damages as a result of our past non-compliance.

Previously, we were subject to three separate yet similar class action complaints filed against us in state court alleging violations of dating service statutes—one in each of Illinois, New York and California. Although all of the complaints were dismissed and are no longer subject to appeal, the opinion in the Illinois case provided that we are subject to the Illinois Dating Services Act and, as such, our subscription agreements violate the act and are void and unenforceable. This ruling may subject us to potential liability for claims brought by the Illinois Attorney General or customers that have been injured by such violation of the statute.

We review the litigation and accrue appropriate amounts where necessary. These assessments and estimates are based on information available to management at the time and involve a significant amount of management judgment. As a result, actual outcomes or losses may differ materially from those envisioned by our current assessments and estimates. We intend to defend vigorously against any litigation claims. However, no assurance can be given that these matters will be resolved in our favor and, depending on the outcome of these disputes, we may choose to alter our business practices. Our failure to successfully defend or settle litigation claims could result in liability that, to the extent not covered by our insurance, could have a material adverse effect on our financial condition and results of operations. Furthermore, the defense of litigation claims may also be both time consuming and expensive.

We are exposed to risks associated with credit card fraud and credit payment, which, if not properly addressed, could increase our operating expenses.

We depend on the continuing availability of credit card usage to process subscriptions and this availability, in turn, depends on acceptable levels of chargebacks and fraud performance. We have suffered losses and may continue to suffer losses as a result of subscription orders placed with fraudulent credit card data, even though the associated financial institution approved payment. Under current credit card practices, a merchant is liable for fraudulent credit card transactions when, as is the case with the transactions we process, that merchant does not obtain a cardholder's signature. Our failure to adequately control fraudulent credit card transactions would result in significantly higher credit card-related costs and, therefore, increase our operating expenses and may preclude us from accepting credit cards as a means of payment.

We face risks associated with our dependence on computer and telecommunications infrastructure.

Our services are dependent upon the use of the Internet and telephone and broadband communications to provide high-capacity data transmission without system downtime. There have been instances where regional and national telecommunications outages have caused us, and other Internet businesses, to experience systems interruptions. Any additional interruptions, delays or capacity problems experienced with telephone or broadband connections could adversely affect our ability to provide services to our customers. The temporary or permanent loss of all, or a portion, of the telecommunications system could cause disruption to our business activities and result in a loss of revenue. Additionally, the telecommunications industry is subject to regulatory control. Amendments to current regulations, which could affect our telecommunications providers, could disrupt or adversely affect the profitability of our business.

In addition, if any of our current agreements with telecommunications providers were terminated, we may not be able to replace any terminated agreements with equally beneficial ones. There can be no assurance that we will be able to renew any of our current agreements when they expire or, if we are able to do so, that such renewals will be available on acceptable terms. We also do not know whether we will be able to enter into additional agreements or that any relationships, if entered into, will be on terms favorable to us.

Our business depends, in part, on the growth and maintenance of the Internet, and our ability to provide services to our members and paying subscribers may be limited by outages, interruptions and diminished capacity of the Internet.

Our performance will depend, in part, on the continued growth and maintenance of the Internet. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security for providing reliable Internet services. Internet infrastructure may be unable to support the demands placed on it if the number of Internet users continues to increase, or if existing or future Internet users access the Internet more often or increase their bandwidth requirements. In addition, viruses, worms and similar programs may harm the performance of the Internet. We have no control over the third-party telecommunications, cable or other providers of access services to the Internet that our members and paying subscribers rely upon. There have been instances where regional and national telecommunications outages have caused us to experience service interruptions during which our members and paying subscribers could not access our services. Any additional interruptions, delays or capacity problems experienced with any points of access between the Internet and our members could adversely affect our ability to provide services reliably to our members and paying subscribers. The temporary or permanent loss of all, or a portion, of our services on the Internet, the Internet infrastructure generally, or our members' and paying subscribers' ability to access the Internet could disrupt our business activities, harm our business reputation, and result in a loss of revenue. Additionally, the Internet, electronic communications and telecommunications industries are subject to federal, state and foreign governmental regulation. New laws and regulations governing such matters could be enacted or amendments may be made to existing regulations at any time that could adversely impact our services. Any such new laws, regulations or amendments to existing regulations could disrupt or adversely affect the profitability of our business.

We are subject to burdensome government regulations and legal uncertainties affecting the Internet that could adversely affect our business.

Our business is regulated by diverse and evolving laws and governmental authorities in the United States and other countries in which we operate. Legal uncertainties surrounding domestic and foreign government regulations could increase our costs of doing business, require us to revise our services, prevent us from delivering our services over the Internet or slow the growth of the Internet, any of which could increase our expenses, reduce our revenue or cause our revenue to grow at a slower rate than expected and materially adversely affect our business, financial condition and results of operations. Laws and regulations related to Internet communications, security, privacy, intellectual property rights, commerce, taxation, entertainment, recruiting and advertising are becoming more prevalent, and new laws and regulations are under consideration by the United States Congress, state legislatures and foreign governments. For example, in recent years, legislation related to the use of background checks for users of online personals services was proposed in Ohio, Texas, California, Michigan, New Jersey, Florida and Virginia. The New Jersey legislature enacted such a law in 2008 and other state legislatures may still be considering the implementation of such legislation. The interpretation of the New Jersey statute as well as the enactment of any of these proposed laws could require us to alter our service offerings and could negatively impact our performance by making it more difficult and costly to obtain new subscribers and may also subject us to additional liability for failure to properly screen our subscribers. Promulgation of new laws, changes in current laws, the existence of ambiguous laws that are difficult to implement, changes in interpretations by courts and other governments officials of existing laws, our inability or failure to comply with current or future laws or strict enforcement by current or future government officers of current or future laws could adversely affect us by reducing our revenue, increasing our operating expenses and exposing us to significant potential liabilities.

Furthermore, in part as a result of current economic conditions, some states have begun to, and others may in the future, impose state taxes on services provided through the Internet, such as online personals, which will increase the cost of our services and could adversely affect our business. Any legislation and regulations enacted or newly enforced or restrictions arising from current or future government investigations or policy could dampen the growth in

use of the Internet, generally, decrease the profitability of Internet related businesses and diminish the acceptance of the Internet as a communications, commercial, entertainment, recruiting and advertising medium. In addition to new laws and regulations being adopted, existing laws that are not currently being applied to the Internet may subsequently be applied to it, in some cases with a retroactive effect or penalty, and, in several jurisdictions, legislatures are considering laws and regulations that would apply to the online personals industry in particular. Many areas of law affecting the Internet and online personals remain unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws such as those governing consumer protection, intellectual property, libel and taxation apply to the Internet or to our services. In the normal course of our business, we handle personally identifiable information pertaining to our members and paying subscribers residing in the United States and other countries. In recent years, many of these countries have adopted privacy, security and data protection laws and regulations intended to prevent improper uses and disclosures of personally identifiable information. In addition, some jurisdictions impose database registration requirements for which significant monetary and other penalties may be imposed for noncompliance. These laws may impose costly administrative requirements, limit our handling of information, and subject us to increased government oversight and financial liabilities. Privacy laws and regulations in the United States and foreign countries are subject to change and may be inconsistent, and additional requirements may be imposed at any time. These laws and regulations, the costs of complying with them, administrative fines for noncompliance and the possible need to adopt different compliance measures in different jurisdictions could materially increase our expenses and cause the value of our securities to decline.

## Risks Related to Owning Our Securities

If an active trading market for our stock is not maintained or if securities analysts downgrade our stock or cease coverage of us, the price of our stock could decline.

We cannot assure you that an active trading market will be sustained or that the market price of our common stock will not decline. The price at which our common stock trades is likely to be highly volatile and may fluctuate substantially due to many factors, some of which are outside of our control. In addition, the stock market has experienced significant price and volume fluctuations that have affected the market price for the stock of many technology, communications and entertainment and media companies. Those market fluctuations were sometimes unrelated or disproportionate to the operating performance of these companies. Any significant stock market fluctuations in the future, whether due to our actual performance or prospects or not, could result in a significant decline in the market price of our securities. Furthermore, the trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us or our business. Currently, three financial analysts publish reports about us and our business. We do not control these or any other analysts. Furthermore, there are many large, well-established, publicly traded companies active in our industry and market, which may mean that it is less likely that we will receive widespread analyst coverage. If any of the analysts who cover us downgrade our stock, our stock price would likely decline rapidly. If these analysts cease coverage of our Company, we could lose visibility in the market, which in turn could cause our stock price to decline.

Our principal stockholders can exercise significant influence over us, and, as a result, may be able to delay, deter or prevent a change of control or other business combination.

As of March 13, 2014, North Run Advisors, LLC, 402 Capital, LLC and Osmium Partners, LLC and their respective affiliates beneficially owned approximately, in the aggregate, 33.5% of our outstanding common stock. These stockholders together possess significant influence over our company. Such ownership and control may have the effect of delaying or preventing a change in control of our company, impeding a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company. Furthermore, such ownership may have the effect of control over substantially all matters requiring stockholder approval, including the election of directors. We do not expect that these stockholders will vote together as a group.

We may implement stock repurchase plans, which may restrict our funds available for other actions and negatively affect the market price of our securities.

In December 2013, we implemented a stock repurchase plan and may implement additional stock repurchase plans in the future. A stock repurchase plan may not have the effects anticipated by our board of directors and may instead harm the market price and liquidity of our securities. The full implementation of any repurchase plan could use a significant portion of our cash reserves, and this use of cash could limit our future flexibility to complete acquisitions of businesses or technology or other transactions. Implementation of a repurchase plan would also result in an increase in the percentage of common stock owned by our existing stockholders, and such increase may trigger disclosure or other regulatory requirements for our larger stockholders. As a result, certain stockholders may liquidate a portion of their holdings, which may have a negative impact on the market price of our securities. Furthermore, repurchases of stock may affect the trading of our common stock to the extent we fail to satisfy continued-listing requirements of the exchange on which our stock trades, including those based on numbers of holders or public float of our common stock. A repurchase plan will also reduce the number of shares of our common stock in the market, which may impact the development of an active trading market in our stock, causing a negative impact on the market price of our stock.

We have never paid any dividend and do not expect to pay dividends in the foreseeable future.



To date, we have not declared or paid any cash dividends on our common stock and currently intend to retain any future earnings for funding growth. We do not anticipate paying any dividends in the foreseeable future. As a result, you should not rely on an investment in our stock if you require dividend income. Capital appreciation, if any, of our stock may be your sole source of gain for the foreseeable future.

Our charter documents and our stockholder rights plan may have anti-takeover effects that could prevent a change in control, which may cause our stock price to decline.

Our certificate of incorporation or our bylaws could make it more difficult for a third party to acquire us, even if closing such a transaction would be beneficial to our stockholders. We are authorized to issue up to 10,000,000 shares of preferred stock. This preferred stock may be issued in one or more series, the terms of which may be determined at the time of issuance by our board of directors without further action by stockholders. The terms of any series of preferred stock may include voting rights (including the right to vote as a series on particular matters), preferences as to dividend, liquidation, conversion and redemption rights and sinking fund provisions. No preferred stock is currently outstanding. The issuance of any preferred stock could materially adversely affect the rights of the holders of our common stock, and therefore, reduce the value of our common stock. In particular, specific rights granted to future holders of preferred stock could be used to restrict our ability to merge with, or sell our assets to, a third party and thereby preserve control by the present management.

There are no cumulative voting rights provided for in our bylaws or certificate of incorporation. Our certificate of incorporation and bylaws also contain provisions that could have the effect of discouraging potential acquisition proposals or making a tender offer or delaying or preventing a change in control, including changes a stockholder might consider favorable. In particular, the certificate of incorporation and bylaws, as applicable, among other things:

- provide the board of directors with the ability to alter the bylaws without stockholder approval;
- provide for an advance notice procedure with regard to the nomination of candidates for election as directors and with regard to business to be brought before a meeting of stockholders; and
- provide that vacancies on the board of directors may be filled by a majority of directors in office, although less than a quorum.

We have also adopted a stockholder rights plan pursuant to which each share of common stock also has a “right” attached to it. The rights are not exercisable except upon the occurrence of certain takeover-related events – most importantly, the acquisition by a third party (the “Acquiring Person”) of more than 30% of our outstanding voting shares if the Acquiring Person has not concurrently made a tender offer to acquire all outstanding shares of common stock. Once triggered, the rights entitle the stockholders, other than the Acquiring Person, to purchase additional shares of common stock at a 50% discount to their fair market value. The effect of triggering the rights is to expose the Acquiring Person to severe dilution of its ownership interest, as the shares of common stock of our company (or any surviving corporation) are offered to all of the stockholders other than the Acquiring Person at a steep discount to their market value.

Such provisions may have the effect of discouraging a third-party from acquiring Spark Networks, Inc. even if doing so would be beneficial to its stockholders. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of Spark Networks, Inc. to first negotiate with its Board. These provisions of Delaware law also may discourage, delay or prevent someone from acquiring or merging with us, which may cause the market price of our common stock to decline.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

#### ITEM 2. PROPERTIES

We do not own any real property that is materially important to our business. Our headquarters is currently located in Los Angeles, California, where we occupy approximately 16,000 square feet of office space, housing our technology department and most of our corporate and administrative personnel. Our current lease for this space runs from February 1, 2013 through October 31, 2018 with monthly basic rent ranging from approximately \$43,117 to \$51,427 with six months of rent abatement, as well as scheduled rent increases and rent credits. We also lease office space in Utah and Israel and datacenter space in California and Utah. We believe that our facilities are adequate for our current needs and suitable additional or substitute space will be available in the future to replace our existing facilities, if necessary, or accommodate expansion of our operations.

ITEM 3. LEGAL PROCEEDINGS

ISYSTEMS v. Spark Networks, Inc. et al.

On July 11, 2008, ISYSTEMS initiated a lawsuit against Spark Networks, Inc. and Spark Networks Limited (collectively, "Spark Networks") and other parties in the United States District Court, Northern District of Texas, Dallas Division. The lawsuit was filed in response to an arbitration award ordering the transfer of the domain name, JDATE.NET, to Spark Networks Limited from ISYSTEMS. Spark Networks was apprised of the lawsuit after ISYSTEMS unsuccessfully attempted to utilize the filing of the lawsuit to prevent the domain transfer to Spark Networks Limited. On December 1, 2008, Spark Networks filed a Motion to Dismiss the Complaint, or, Alternatively, for Summary Judgment. On September 10, 2009, the Court granted Spark Networks' motion and dismissed the case with prejudice. On September 22, 2009, ISYSTEMS filed a motion to vacate the order dismissing the action and requesting leave to amend its complaint. On October 26, 2009, the Court granted ISYSTEMS' motion and ISYSTEMS filed its Amended Complaint on November 25, 2009. On January 19, 2010, Spark Networks filed a Motion to Dismiss the Amended Complaint, or Alternatively, for Summary Judgment. The Court granted Spark Networks' Motion to Dismiss on June 28, 2010 and entered a judgment in favor of Spark Networks. On July 25, 2010, ISYSTEMS filed a motion to vacate the order granting the motion to dismiss, which was denied by the Court on August 11, 2010. On September 10, 2010, ISYSTEMS filed a notice of appeal of the district court's order and judgment to the United States Court of Appeals for the Fifth Circuit. On June 13, 2011, the United States Court of Appeals for the Fifth Circuit issued its opinion affirming the District Court's judgment. On June 29, 2011, ISYSTEMS filed a Petition for Rehearing with the United States Court of Appeals for the Fifth Circuit, which was granted. Oral argument was held on December 8, 2011. Per the Fifth Circuit's request, the parties submitted supplemental briefs on December 16, 2011. On March 21, 2012, the Fifth Circuit issued its opinion affirming the District Court's dismissal of certain claims and reversing the dismissal of certain other claims. On April 19, 2012, the matter was remanded back to the District Court. On September 4, 2012, Spark Networks filed its Answer to the Complaint. By written order dated August 30, 2012, the Court set the action for trial on February 24, 2014. On January 22, 2014, the Court entered an Amended Scheduling Order continuing the commencement of the trial to July 21, 2014.

Kirby, et al. v. Spark Networks USA, LLC

On October 16, 2012, Kristina Kirby, Christopher Wagner and Jamie Carper (collectively referred to as "Plaintiffs"), on behalf of themselves and all other similarly situated, filed a putative class action Complaint in the Superior Court for the State of California, County of Los Angeles alleging claims against Spark Networks USA, LLC for violations of California Business & Professions Code section 17529.5. Plaintiffs allege that certain e-mail communications advertising websites of Spark Networks USA, LLC and received by Plaintiffs violate a California statute prohibiting false and deceptive e-mail communications (namely, California Business & Professions Code section 17529.5). Plaintiffs generally allege that they seek damages in excess of \$25,000. As of March 28, 2013, the e-mail publishers responsible for distributing the e-mails at issue in this litigation have agreed to furnish a complete defense to the Company, through independent counsel at their own expense, pursuant to contractual indemnification provisions. The parties reached a settlement in principle to resolve the action on December 10, 2013, and are currently in the process of documenting the settlement for court approval.

Adconion v. Spark Networks USA, LLC

On December 18, 2013, Adconion Direct, Inc. ("Adconion") filed a breach of contract lawsuit in the Superior Court of California of Los Angeles. Adconion alleges that it is a successor-in-interest to Frontline Direct Inc., with which Spark contracted for the placement of online advertisements. Adconion contends that it has performed all of its obligations pursuant to this contract, and that Spark failed to pay the January and February 2013 invoices, which total \$437,729. Spark filed an answer to the complaint on February 3, 2014 along with a cross complaint against Adconion for breach of contract, breach of the implied covenant of good faith and fair dealing, express contractual indemnity,

fraudulent concealment and negligent interference with prospective economic advantage.

California Unruh Act Litigation

Werner, et al. v. Spark Networks, Inc. and Spark Networks USA, LLC and Wright, et al. v. Spark Networks, Inc., Spark Networks USA, LLC, et al.

On July 19, 2013, Aaron Werner, on behalf of himself and all other similarly situated individuals, filed a putative class action Complaint in the Superior Court for the State of California, County of Los Angeles alleging a single claim seeking an injunction and statutory, general and compensatory, treble and punitive damages as well as attorneys' fees and costs and pre-judgment interest based on the allegation that Spark Networks' ChristianMingle website violates California's Unruh Civil Rights Act by allegedly discriminating based on sexual orientation. On December 23, 2013, Richard Wright, on behalf of himself and all other similarly situated individuals, filed a putative class action complaint (the "Complaint") in the Superior Court for the State of California, County of San Francisco alleging a single claim against Spark Networks, Inc., seeking an injunction and statutory, general, compensatory and punitive damages as well as attorneys' fees, costs and pre-judgment interest, based on the allegation that certain of the Company's websites violate California's Unruh Civil Rights Act by allegedly discriminating based on sexual orientation.

Israeli Consumer Actions

Ben-Jacob vs. Spark Networks (Israel) Ltd. and Gever vs. Spark Networks (Israel) Ltd. and Korland vs. Spark Networks (Israel) Ltd.

Three class action lawsuits have been filed in Israel alleging violations of the Israel Consumer Protection Law of 1981. Spark was served with a Statement of Claim and a Motion to Certify it as a Class Action in the Ben-Jacob action on January 14, 2014. The plaintiff alleges that Spark Networks (Israel) Ltd. refused to cancel her subscription and provide a refund for unused periods and claims that such a refusal is in violation of the Consumer Protection Law. Spark was served with a Statement of Claim and a motion to Certify it as a Class Action in the Gever action on January 21, 2014. The plaintiff alleges that Spark Networks (Israel) Ltd. renewed his one month subscription without receiving his positive agreement in advance and claims that such renewal is prohibited under the Consumer Protection Law. Spark was served with a Statement of Claim and a Motion to Certify it as a Class Action in the Korland action on February 12, 2014. The plaintiff alleges that Spark Networks (Israel) Ltd. refused to give her a full refund and charged her the price of a one month subscription to the JDate website in violation of the Consumer Protection Law. In each of these three cases, the plaintiff is seeking personal damages and damages on behalf of a defined group.

We intend to defend vigorously against each of the lawsuits. However, no assurance can be given that these matters will be resolved in our favor and, depending on the outcome of these lawsuits, we may choose to alter our business practices.

We have additional existing legal claims and may encounter future legal claims in the normal course of business. In our opinion, the resolutions of the existing legal claims are not expected to have a material impact on our financial position or results of operations. We believe we have accrued appropriate amounts where necessary in connection with the above litigation.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

## PART II.

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

## Market Information

Spark Networks, Inc.'s common stock is traded on the NYSE MKT under the trading symbol "LOV." The following table summarizes the high and low closing sales prices of our common stock as reported by the NYSE MKT.

	High	Low
Year ended December 31, 2012		
First Quarter	\$4.74	\$3.62
Second Quarter	\$5.73	\$4.24
Third Quarter	\$6.81	\$5.02
Fourth Quarter	\$7.90	\$5.97

	High	Low
Year ended December 31, 2013		
First Quarter	\$8.15	\$7.00
Second Quarter	\$9.00	\$6.56
Third Quarter	\$8.91	\$6.73
Fourth Quarter	\$8.25	\$5.39

## Holders

As of March 13, 2014 there were 44 holders of record of our common stock.

## Dividends

We have not declared or paid any cash dividends on our common stock. We presently intend to retain our future earnings, if any, to fund the development and growth of our business and, therefore, do not have plans to pay any cash dividends in the near future.

Pursuant to the Company's credit agreement, as further described in "Management Discussion and Analysis of Financial Condition and Results of Operations", the Company is permitted to repurchase or redeem equity interests or issue dividends of up to \$4.5 million during the term of the credit agreement.

## Securities Authorized for Issuance Under Equity Compensation Plans

Our equity compensation plan information is provided as set forth in Part III, Item 11 herein.

## Unregistered Sales of Equity Securities

During the year ended December 31, 2013, we did not issue unregistered securities.

### Purchases of Equity Securities

On December 12, 2013, our Board of Directors authorized the repurchase of up to \$5.0 million of our common stock. The repurchases may be made from time to time in the open market, in privately negotiated transactions, or otherwise, including pursuant to a Rule 10b5-1 plan, at prices that the Company deems appropriate and subject to market conditions, applicable law, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended, and other factors deemed relevant in the Company's sole discretion. The Company is not obligated to repurchase any dollar amount or any number of shares of common stock, and the program may be suspended, discontinued or modified at any time, for any reason and without notice.

We did not purchase any shares in the three months ended December 31, 2013.

### ITEM 6. SELECTED FINANCIAL DATA

Pursuant to Item 10(f) of Regulation S-K, the Company is not required to satisfy the accelerated filer disclosure requirements until the first quarter after the determination date fiscal year. As such, the Company is not required to provide the information under this item.



## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and the related notes that are included in this report.

Some of the statements contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report are forward-looking statements that involve substantial risks and uncertainties. All statements other than historical facts contained in this report, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "believes," "expects," "anticipates," "intends," "estimates," "may," "will," "continue," "should," "plan," "predict," "potential" and other similar expressions. We have based these forward-looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Our actual results could differ materially from those anticipated in these forward-looking statements, which are subject to a number of risks, uncertainties and assumptions described in the "Risk Factors" section and elsewhere in this report.

### General

The common stock of Spark Networks, Inc., a Delaware corporation, is traded on the NYSE MKT. On December 31, 2010, Spark Networks Limited ("SNUK") distributed its shareholdings in each of HurryDate, LLC; MingleMatch, Inc.; Kizmeet, Inc.; SN Holdco, LLC; SN Events, Inc.; Reseaux Spark Canada Ltd. and Spark SocialNet, Inc. by transferring its shares in those companies to Spark Networks, Inc. Spark Networks, Inc. subsequently transferred all of its shares in the same companies to LOV USA, LLC, a newly formed and wholly owned subsidiary of Spark Networks, Inc. SNUK continues to hold all of the shares of Spark Networks (Israel) Limited, and JDate Limited. In addition, SNUK now holds all of the shares of Spark Networks USA, LLC, a newly formed subsidiary into which SNUK has transferred all of its United States based assets.

Membership to the Company's online services, which includes the posting of a personal profile and photos, and access to its database of profiles, is free. The Company typically charges a subscription fee for varying subscription lengths (typically, one, three, six and twelve months) to members, allowing them to initiate communication with other members and subscribers using the Company's onsite communication tools, including anonymous email, Instant Messenger, chat rooms and message boards. For most of the Company's services, two-way communications through the Company's email platform can only take place between paying subscribers.

For the year ended December 31, 2013, we had 297,696 average paying subscribers, representing an increase of 14.8% from the year ended December 31, 2012. Paying subscribers are defined as individuals who have paid a monthly fee for access to communication and Web site features beyond those provided to our non-paying members. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in such period.

Our key Web sites include ChristianMingle.com, which primarily targets Christian singles in the United States and JDate.com, which primarily targets Jewish singles in the United States. Our subscription fees have traditionally been charged on a monthly basis, with discounts for longer-term subscriptions.

We have grown both internally and through acquisitions of entities, and selected assets of entities, offering online personals services and related businesses. Through our business acquisitions, we have expanded into new markets, leveraged and enhanced our existing brands to improve our position within new markets, and gained valuable

intellectual property.

Our ability to compete effectively will depend on the timely introduction and performance of our future Web sites, services and features, the ability to address the needs of our members and paying subscribers and the ability to respond to Web sites, services and features introduced by competitors. To address this challenge, we have invested and will continue to invest in existing personnel resources, namely product managers, application developers and systems engineers, in order to enhance our existing services and introduce new services, which may include new Web sites as well as new features and functions designed to increase the probability of communication among our members and paying subscribers and to enhance their online personals experiences. We believe we have sufficient cash resources on hand to accomplish the enhancements currently contemplated.

25

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## Critical Accounting Policies, Estimates and Assumptions

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, cost of revenue, prepaid advertising, Web site and software development costs, goodwill, intangible and other long-lived assets, accounting for business combinations, legal contingencies, income taxes and stock-based compensation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management has discussed the development and selection of our critical accounting policies, estimates and assumptions with our board of directors and the board has reviewed these disclosures. Past estimates have been in line with actual results.

We believe the following critical accounting policies reflect the more significant judgments and estimates we used in the preparation of our consolidated financial statements:

### Revenue Recognition and Deferred Revenue

Substantially all of our revenue is derived from subscription fees. Revenue is presented net of credits and credit card chargebacks. We recognize revenue in accordance with accounting principles generally accepted in the United States. Revenue recognition occurs ratably over the subscription period, beginning when there is persuasive evidence of an arrangement, delivery has occurred (access has been granted), the fees are fixed or determinable, and collection is reasonably assured. Paying subscribers primarily pay in advance using a credit card and, subject to certain conditions identified in our terms and conditions, all purchases are final and nonrefundable. Subscription fees collected in advance are deferred and recognized as revenue, using the straight-line method, over the term of the subscription. We reserve for potential credit card chargebacks based on our historical chargeback experience.

We also earn a small amount of revenue from advertising sales and offline events. We record advertising revenue as it is delivered and included it in the total revenue of each segment that generates advertising sales. Revenue and the related expenses associated with offline events are recognized at the conclusion of each event.

### Cost of Revenue

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. We incur substantial advertising expenses in order to generate traffic to our Web sites. These advertising costs consist of television and online advertising, including affiliate and co-brand arrangements, and are directly attributable to the revenue we receive from our subscribers. We have entered into numerous affiliate arrangements, under which our affiliates advertise or promote our Web site, and earn a fee whenever visitors click through the affiliate's advertisement to one of our Web sites and register or subscribe, on our Web site. Some of our affiliates may also be affiliates for our competitors. Under our co-branded arrangements, our co-brand partners may operate their own separate Web sites where visitors can register and subscribe to our Web sites. Affiliate deals, co-brand deals and online advertising arrangements may fall in the categories of CPS, CPA, CPC, or CPM, as discussed below.

Our advertising expenses are recognized based on the terms of each individual contract. The majority of our advertising expenses are based on five pricing models:

Cost per subscription (CPS) where we pay an online advertising provider a fee based upon the number of new paying subscribers it generates;

Cost per acquisition (CPA) where we pay an online advertising provider a fee based on the number of new member registrations it generates;

Cost per click (CPC) where we pay an online advertising provider a fee based on the number of clicks to our Web sites it generates;

Cost per thousand for banner advertising (CPM) where we pay an online advertising provider a fee based on the number of times it displays our advertisements; and

Offline where we pay television and radio stations for advertising placement on a cost per spot basis, print advertisers on a cost per page basis and out-of-home advertisers on a fixed placement basis.

26

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We estimate, in certain circumstances, the total clicks or impressions delivered by our vendors in order to determine amounts due under these contracts.

#### Prepaid Advertising Expenses

In certain circumstances, we pay in advance for online and offline advertising, and expense the prepaid amounts as cost of revenue over the contract periods as the vendor delivers on its commitment. We evaluate the realization of prepaid amounts at each reporting period and expense prepaid amounts if the vendor is unable to deliver on its commitment and is not willing or able to repay the undelivered prepaid amounts.

#### Web Site and Software Development Costs

We capitalize costs related to developing or obtaining internal-use software. Capitalization of costs begins after the preliminary project stage has been completed. Web site and software development costs are expensed as incurred or capitalized into property and equipment. Costs incurred in the planning and post-implementation stages of an internal use software project are expensed as incurred while direct costs associated with the development phase are capitalized and amortized on a straight-line basis over the estimated useful lives. Costs associated with minor enhancements and maintenance for a Web site are included in expenses in the accompanying consolidated statements of operations.

#### Valuation of Goodwill, Identified Intangibles and Other Long-lived Assets

We test goodwill and indefinite-lived intangible assets for impairment at least annually, or more frequently when circumstances indicate that the carrying value may not be recoverable and test property, plant and equipment and other intangible assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Our operating segments represent the reporting units to which we assign goodwill. We aggregate our indefinite-lived intangible assets, primarily consisting of domain names, into one unit of account for each reporting unit. Factors we consider important and which could trigger an impairment review include the following:

- a significant decline in actual projected revenue;
- a significant decline in the market value of our common stock;
- a significant decline in performance of certain acquired companies relative to our original projections;
- an excess of our net book value over our market value;
- a significant decline in our operating results relative to our operating forecasts;
- a significant change in the manner of our use of acquired assets or the strategy for our overall business;
- a significant decrease in the fair value of an asset;
- a shift in technology demands and development; and
- a significant turnover in key management or other personnel.

When we determine that the carrying value of goodwill, other intangible assets and other long-lived assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. In the case of the other intangible assets and other long-lived assets, this measurement is only performed if the projected undiscounted cash flows for the asset are less than its carrying value.

In 2011, the Company performed its annual impairment analysis utilizing a quantitative assessment. We estimated the fair value of the reporting units based on the market approach and income approach. The income approach relies upon discounted future cash flows which are derived from various assumptions including: projected cash flows, discount rates, projected long-term growth rates and terminal values. The Company used a discount rate which reflects the risks and uncertainty related to each reporting unit. The analysis concluded that the estimated reporting units' fair values

were higher than their carrying values.

In 2013 and 2012, the Company performed its annual impairment analysis. Utilizing the qualitative assessment option, we assessed qualitative factors to determine whether it was necessary to perform the two-step test (quantitative assessment). The analysis concluded that it is more-likely-than-not that the fair values of the Jewish Networks, Christian Networks, and Other Networks are higher than their carrying values. At December 31, 2013, the Company estimated that the fair values of its reporting units exceeded the carrying amounts of such reporting units.

27

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As of December 31, 2013, Jewish Networks, Christian Networks, and Other Networks carried goodwill balances of \$7.4 million, \$1.7 million, and \$0.2 million, respectively.

In 2013, the Company had an impairment expense of \$265,000, representing the full unamortized balance of capitalized software development costs related to certain web-based products that failed to perform to Company standards. In 2012, no impairment charge was necessary.

In 2011, we impaired approximately \$45,000 of capitalized software development costs when we determined that a Web-based product failed to perform to Company standards.

In 2011, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value based upon the expected future cash flows generated from the businesses associated with these assets, resulting in impairment charges of approximately \$1.1 million.

#### Accounting for Business Combinations

We acquired the stock or specific assets of a number of companies from 1999 through 2013 some of which were considered to be business acquisitions. Under the purchase method of accounting, the costs are allocated to the underlying net assets, based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill.

The judgments made in determining the estimated fair value and expected useful life assigned to each class of assets and liabilities acquired can significantly impact net income. Different classes of assets will have varying useful lives. For example, the useful life of a member database, which is typically three years, is not the same as the useful life of a paying subscriber list, which is typically three months, or a domain name, which is indefinite. Consequently, to the extent a longer-lived asset is ascribed greater value under the purchase method than a shorter-lived asset, there may be less amortization recorded in a given period or no amortization for indefinite lived intangibles.

Determining the fair value of certain assets and liabilities acquired is subjective in nature and often involves the use of significant estimates and assumptions.

The value of our intangible and other long-lived assets, including goodwill, is exposed to future adverse changes if we experience declines in operating results or experience significant negative industry or economic trends or if future performance is below historical trends.

#### Legal Contingencies

We are currently involved in certain legal proceedings, as discussed in the notes to the financial statements and under "Legal Proceedings." To the extent that a loss related to a contingency is reasonably estimable and probable, we accrue an estimate of that loss. Because of the uncertainties related to both the amount and range of loss on certain pending litigation, we may be unable to make a reasonable estimate of the liability that could result from an unfavorable outcome of such litigation. As additional information becomes available, we will assess the potential liability related to our pending litigation and make or, if necessary, revise our estimates. Such revisions in our estimates of the potential liability could materially impact our results of operations and financial position.

#### Accounting for Income Taxes

We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and tax

bases of the assets and liabilities.

As of December 31, 2013, we had a valuation allowance against our deferred tax assets of approximately \$14.4 million. Companies are required to assess whether a valuation allowance should be recorded against their deferred tax assets (“DTAs”) based on the consideration of all available evidence, using a “more likely than not” realization standard. In accordance with ASC 740, cumulative losses in recent years, which the Company defines as the most recent three year period, is considered significant negative evidence in evaluating the realizability of DTAs that is difficult to overcome. In light of the Company’s recent history of losses, we are not able to conclude that it is more likely than not that our DTAs will be realized and we recorded a valuation allowance against our DTAs, with a corresponding charge to our income tax provision, of approximately \$4.7 million and \$8.9 million as of December 31, 2013 and 2012, respectively.

28

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At December 31, 2013, we had gross net operating loss (“NOL”) carry-forwards for income tax purposes of approximately \$34.7 million and \$45.7 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2025 for federal purposes and 2018 for state purposes. Under section 382 of the Internal Revenue Code, the utilization of the net operating loss carry-forwards can be limited based on changes in the percentage ownership of the Company.

The Company recognizes excess tax benefits associated with the exercise of stock options directly to stockholders’ equity only when realized. Accordingly, deferred tax assets are not recognized for net operating losses resulting from excess tax benefits. As of December 31, 2013, deferred tax assets do not include approximately \$5.3 million of these excess tax benefits from employee stock option exercises that are a component of the Company’s NOL carry forwards. Additional paid in capital will be increased up to an additional \$5.3 million if and when such excess tax benefits are realized. However, to the extent additional paid-in capital has been recognized for qualifying excess tax deductions from previous share-based payments, the write-off of the deferred tax asset when the tax deduction is less than recognized compensation cost is charged to additional paid-in capital, with any remainder charged to provision for income taxes.

We operate in multiple taxing jurisdictions, both within the United States and outside the United States. We have filed tax returns with positions that may be challenged by the tax authorities. These positions relate to, among others, transfer pricing, the deductibility of certain expenses, intercompany transactions as well as other matters. Although the outcome of tax audits is uncertain, we regularly assesses our tax position for such matters and, in management’s opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. To the extent reserves are recorded, they will be utilized or reversed once the statute of limitations has expired and/or at the conclusion of the tax examination. We believe that the ultimate outcome of these matters will not have a material impact on our financial position or liquidity. We recognize the tax effects from an uncertain tax position in our financial statements, only if the position is more-likely-than-not of being sustained on audit, based on the technical merits of the position. Tax positions that meet the recognition threshold are reported at the largest amount that is more-likely-than-not to be realized.

#### Stock Based Compensation

We adopted the “Share-Based Payment” guidance in 2005 using the modified prospective approach. Prior to our adoption of the guidance, we did not record tax benefits of deductions resulting from the exercise of stock options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2013, the Company did not recognize any cash inflows or outflows related to a tax benefit from stock-based compensation.

We calculate the fair value of stock options using the Black-Scholes option-pricing model. The determination of the fair value of stock-based awards at the grant date requires judgment in developing assumptions, which involve a number of variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards, the expected dividend yield and the expected stock option exercise behavior. Additionally, judgment is also required in estimating the number of stock-based awards that are expected to be forfeited. We used historical and empirical data to assess different forfeiture rates for three different groups of employees. We must reassess forfeiture rates when deemed necessary and we must calibrate actual forfeiture behavior to what has already been recorded.

Our computation of expected volatility is based on a combination of historical and market-based implied volatility. The volatility rate was derived by examining historical stock price behavior and assessing management’s expectations of stock price behavior during the term of the option. The term of the options was derived based on the “simplified

method" calculation. The simplified method allows companies that do not have sufficient historical experience to provide a reasonable basis for an estimate to instead estimate the expected term of a "plain vanilla" option by averaging the time to vesting and the full term of the option. ("Plain vanilla" options are options with the following characteristics: (1) the options are granted at-the-money; (2) exercisability is conditional only upon performing service through the vesting date; (3) if an employee terminates service prior to vesting, the employee would forfeit the options; (4) if an employee terminates service after vesting, the employee would have a limited time to exercise the options (typically 30 to 90 days); and (5) the options are nontransferable and non-hedgeable.) We periodically evaluate the applicability of using the simplified method with respect to the characteristics noted above with respect to our options and will continue to do so as our business continues to evolve. If any of the assumptions used in the Black-Scholes model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. We believe the accounting for stock-based compensation is a critical accounting policy because it requires the use of complex judgment in its application.

## Segment Reporting

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for making operating decisions and assessing performance. The Company's financial reporting includes detailed data on four separate operating segments which were principally determined based on similarity of economic characteristics. During the first quarter of 2012, the Company's management modified the internal reporting of its operating segments to: (1) Jewish Networks, which consists of JDate.com, JDate.co.uk, JDate.fr, JDate.co.il, Cupid.co.il, and their respective co-branded Web sites; (2) Christian Networks, which now consists of ChristianMingle.com, ChristianMingle.co.uk, ChristianMingle.com.au, Believe.com, ChristianCards.net, DailyBibleVerse.com and Faith.com; (3) Other Networks, which consists of Spark.com and related other general market Web sites as well as other properties which are primarily composed of sites targeted towards various religious, ethnic, geographic and special interest groups; and (4) Offline & Other Businesses, which consists of revenue generated from offline activities and HurryDate events and subscriptions. The Company believes the new segments provide investors with greater transparency into the performance of the business. Prior period amounts presented in this Annual Report on Form 10-K have been reclassified to conform to the current period presentation.

## Results of Operations

The following is a more detailed discussion of our financial condition and results of operations for the periods presented.

The following table presents our historical operating results as a percentage of revenue for the periods indicated:

	2013		2012	2011
Revenue	100.0	%	100.0%	100.0%
Costs and expenses:				
Cost of revenue	80.6		79.7	59.7
Sales and marketing	8.1		6.5	7.7
Customer service	4.2		4.1	4.1
Technical operations	1.7		2.2	2.8
Development	4.5		5.4	5.6
General and administrative	15.1		14.3	16.6
Depreciation	2.9		2.7	2.7
Amortization of intangible assets other than goodwill	—		—	0.8
Impairment of goodwill, long-lived assets and other assets	0.4		—	2.4
Total costs and expenses	117.5		114.9	102.4
Operating loss	(17.5	)	(14.9	(2.4
Interest expense (income) and other, net	(0.3	)	(0.4	0.3
Loss before income taxes	(17.2	)	(14.5	(2.7
Provision for income taxes	0.7		9.8	0.6
Net loss	(17.9	)%	(24.3	(3.3



The following table describes certain selected information and Adjusted EBITDA <sup>(1)</sup> for the years ended December 31,

(in thousands)	2013	2012	2011
Net loss	\$(12,380)	\$(14,989)	\$(1,611)
Interest expense	71	59	102
Income tax provision	495	6,047	305
Depreciation	1,987	1,673	1,320
Impairments	265	—	1,145
Amortization of intangible assets	20	13	370
Non-cash currency translation adjustments	(297 )	(124 )	337
Stock-based compensation	767	813	906
Non-repetitive property possession	—	(151 )	(247 )
Adjusted EBITDA <sup>(1)</sup>	\$(9,072 )	\$(6,659 )	\$2,627

(1)The Company reports Adjusted EBITDA as a supplemental measure to generally accepted accounting principles (“GAAP”). This measure is one of the primary metrics by which we evaluate the performance of our businesses, budget, forecast and compensate management. We believe this measure provides management and investors with a consistent view, period to period, of the core earnings generated from on-going operations and excludes the impact of: (i) non-cash items such as stock-based compensation, asset impairments, non-cash currency translation adjustments related to an inter-company loan and (ii) one-time items that have not occurred in the past two years and are not expected to recur in the next two years. Adjusted EBITDA has inherent limitations in evaluating the performance of the Company, including, but not limited to the following:

Adjusted EBITDA does not reflect the cash capital expenditures during the measurement period,

Adjusted EBITDA does not reflect any changes in working capital requirements during the measurement period,

Adjusted EBITDA does not reflect the cash tax payments during the measurement period, and

Adjusted EBITDA may be calculated differently by other companies in our industry, thus limiting its value as a comparative measure.

Adjusted EBITDA should not be construed as a substitute for net income (loss) (as determined in accordance with GAAP) for the purpose of analyzing our operating performance or financial position, as Adjusted EBITDA is not defined by GAAP.

#### Key Metric - Average Paying Subscribers

We regularly review average paying subscribers as a key metric to evaluate the effectiveness of our operating strategies and monitor the financial performance of our business. Subscribers are defined as individuals for whom we collect a monthly fee for access to communication and Web site features beyond those provided to our non-paying members. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in such period.

Unaudited selected statistical information regarding average paying subscribers for our operating segments is shown in the table below:

Year Ended December 31,

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	2013	2012	2011
Average Paying Subscribers			
Jewish Networks	84,149	85,292	89,429
Christian Networks	193,316	146,267	71,311
Other Networks	20,232	27,685	35,595
Total Average Paying Subscribers	297,697	259,244	196,335

Average paying subscribers for the Jewish Networks segment decreased 1.3% to 84,149 for the year ended December 31, 2013 compared to 85,292 in 2012. Average paying subscribers for the Christian Networks segment increased 32.2% to 193,316 for the year ended December 31, 2013 compared to 146,267 in 2012, reflecting increased direct marketing investment within this segment. Average paying subscribers for the Other Networks segment decreased 26.9% to 20,232 for the year ended December 31, 2013 compared to 27,685 in 2012. This decrease can be primarily attributed to a reduction in inefficient marketing spend in prior and current periods.

Average paying subscribers for the Jewish Networks segment decreased 4.6% to 85,292 for the year ended December 31, 2012 compared to 89,429 in 2011, reflecting the 8.2% reduction in direct marketing investment. Average paying subscribers for the Christian Networks segment increased 105.1% to 146,267 for the year ended December 31, 2012 compared to 71,311 in 2011, reflecting increased direct marketing investment within this segment. Average paying subscribers for the Other Networks segment decreased 22.2% to 27,685 for the year ended December 31, 2012 compared to 35,595 in 2011. This decrease can be primarily attributed to a reduction in inefficient marketing spend in prior and current periods.

We expect the cost of customer acquisition for the Jewish Networks to remain below the acquisition cost for our other segments due to the brand recognition of JDate. Our Christian Networks and Other Networks segments operate in a much more competitive environment, and therefore we generally must spend more on marketing to attract new subscribers. We are constantly striving to improve our Web sites to retain our existing subscribers.

#### Year Ended December 31, 2013 Compared to Year Ended December 31, 2012

##### Revenue

Substantially all of our revenue is derived from subscription fees. Approximately 4.5% and 4.8% of our revenue for the years ended December 31, 2013 and 2012, respectively, were generated through offline social and travel events, and advertising revenue. Revenue is presented net of credits and credit card chargebacks. Our subscriptions are offered in durations of varying length (typically, one, three, six and twelve months). Plans with durations longer than one month are available at discounted monthly rates. Following their initial terms, most subscriptions renew automatically until subscribers terminate them.

Revenue for the year ended December 31, 2013 increased 12.4% to \$69.4 million from \$61.7 million in 2012. The revenue increase can be primarily attributed to a 27.5% increase in Christian Networks revenue.

Revenue for the Jewish Networks segment decreased 0.9% to \$25.8 million for the year ended December 31, 2013, compared to \$26.0 million in 2012. The lower Jewish Networks revenue reflects lower online advertising revenue. Revenue for our Christian Networks segment increased 27.5% to \$40.2 million for the year ended December 31, 2013, compared to \$31.6 million in 2012. The higher Christian Networks revenue reflects a 32.2% increase in average paying subscribers, driven by a 16.0% increase in direct marketing investment. Revenue for the Other Networks segment decreased 21.1% to \$3.0 million for the year ended December 31, 2013, compared to \$3.8 million in 2012. The decrease in Other Networks revenue is driven by a 26.9% decrease in average paying subscribers, reflecting the elimination of inefficient online marketing investments in 2013 and 2012.

##### Costs and Expenses

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses increased 14.9% to \$81.5 million for the year ended December 31, 2013, compared to \$70.9 million in 2012. The increase is primarily attributable to a \$6.4 million increase in cost of revenue, a \$1.6 million increase in sales and marketing and a \$1.7 million increase in general and administrative expenses.

Cost of Revenue. Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue increased 13.7% to \$56.0 million for the year ended December 31, 2013, compared to \$49.2 million in 2012. This increase can be primarily attributed to higher Christian Networks direct marketing expenses. Direct marketing expenses for the Christian Networks segment increased 16.0%

to \$48.0 million for the year ended December 31, 2013, compared to \$41.4 million in 2012. The higher direct marketing expense reflects management's focus on increasing market share and cultivating greater brand awareness for ChristianMingle through increased offline marketing efforts.

**Sales and Marketing.** Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel and consulting fees. Sales and marketing expenses increased 40.3% to \$5.6 million for the year ended December 31, 2013, compared to \$4.0 million in 2012. The increase can be primarily attributed to growth in compensation expense and consulting fees. The Company expanded its product management and customer acquisition teams and further built out the media business group in 2013, which led to higher compensation expense. Additionally, the Company worked with a variety of consultants to further grow our burgeoning media business, enhance the Company's creative advertising campaigns for the Jewish and Christian Networks and perform market research.

**Customer Service.** Customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members. Customer service expenses increased 14.5% to \$2.9 million for the year ended December 31, 2013, compared to \$2.5 million in 2012. The expense increase is primarily attributed to higher compensation costs, reflecting increased support for our growing Christian Networks segment.



**Technical Operations.** Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses decreased 14.4% to \$1.2 million for the year ended December 31, 2013, compared to \$1.4 million in 2012. The decrease can be primarily attributed to a reduction in compensation and stock-based compensation expense.

**Development.** Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses decreased 6.5% to \$3.1 million for the year ended December 31, 2013, compared to \$3.3 million in 2012. The decrease can be attributed to lower consulting fees associated with the development of our media properties.

**General and Administrative.** General and administrative expenses consist primarily of corporate personnel-related costs, professional fees, occupancy and other overhead costs. General and administrative expenses increased 19.4% to \$10.5 million for the year ended December 31, 2013, compared to \$8.8 million in 2012. The increase can be primarily attributed to higher legal and accounting expenses. The higher legal fees reflect costs associated with several litigation matters while the higher accounting fees primarily reflect costs associated with our Sarbanes-Oxley compliance. As of December 31, 2013, we became an accelerated filer, which requires our independent auditor to perform additional work, including attesting to our internal controls over financial reporting for our 2013 annual financial statements.

**Depreciation.** Depreciation expenses consist primarily of depreciation of capitalized Web site and software development costs, computer hardware and other fixed assets. Depreciation expense increased by 18.8% to \$2.0 million for the year ended December 31, 2013, compared to \$1.7 million in 2012. Higher capitalized Web site and software development costs accounted for the increase in depreciation expenses.

**Amortization of Intangible Assets.** Amortization expenses consist primarily of amortization of intangible assets related to acquisitions. Amortization expense increased 53.8% to \$20,000 for the year ended December 31, 2013, compared to \$13,000 in 2012. The increase reflects the amortization of certain digital media assets purchased by the Company in 2013.

**Impairment of Long-lived Assets.** Impairment of long-lived assets primarily represents the write-down of investments in businesses and computer software. Impairment of long-lived assets was \$265,000 for the year ended December 31, 2013 compared to \$0 in 2012. The expense in 2013 reflects the write-off of certain underperforming software assets.

**Interest Expense (Income) and Other, Net.** Interest expense (income) and other consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Interest expense (income) and other reflected \$229,000 of income for the year ended December 31, 2013, compared to \$238,000 of income in 2012. In 2013, the income is primarily related to non-cash foreign exchange rate fluctuations related to the intercompany loan with our Israel subsidiary. In 2012, the income is primarily related to a \$124,000 gain associated with non-cash foreign exchange rate fluctuations related to the intercompany loan with our Israel subsidiary and a \$151,000 gain associated with the sale of certain real property.

**Provision for Income Taxes.** Provision for income taxes for the year ended December 31, 2013 was \$495,000, compared to \$6.0 million for the year ended December 31, 2012. We did not recognize a tax benefit for losses incurred in 2013, as we recorded a valuation allowance against our deferred tax assets. The 2013 provision for income tax consists of \$344,000 of deferred tax related to an increase in the deferred tax liability associated with tax deductible amortization of goodwill and other indefinite lived intangibles, \$62,000 of foreign and state current tax and \$89,000 related to interest accrued on unrecognized tax benefits. The 2012 provision for income taxes consists primarily of a valuation allowance recorded against our deferred tax assets, for which we were not able to conclude that it is more likely than not it would be realized. As a result of the valuation allowance position, no tax benefit was

recorded on the losses incurred for the year.

Net Loss and Net Loss Per Share. Net loss was \$12.4 million, or \$0.54 per share, for the year ended December 31, 2013, compared to a net loss of \$15.0 million, or \$0.72 per share in 2012. The reduction in net loss and net loss per share was primarily due to a lower income tax provision in 2013.

Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

#### Revenue

Substantially all of our revenue is derived from subscription fees. Approximately 4.8% and 5.0% of our revenue for the years ended December 31, 2012 and 2011, respectively, were generated through offline social and travel events, and advertising revenue. Revenue is presented net of credits and credit card chargebacks. Our subscriptions are offered in durations of varying length (typically, one, three, six and twelve months). Plans with durations longer than one month are available at discounted monthly rates. Following their initial terms, most subscriptions renew automatically until subscribers terminate them.

Revenue for the year ended December 31, 2012 increased 27.3% to \$61.7 million from \$48.5 million in 2011. The revenue increase can be primarily attributed to a 100.6% increase in Christian Networks revenue.

Revenue for the Jewish Networks segment decreased 3.8% to \$26.0 million for the year ended December 31, 2012, compared to \$27.1 million in 2011. The lower Jewish Networks revenue reflects a 4.6% decrease in average paying subscribers. An 8.2% decrease in Jewish Networks direct marketing investment contributed to the lower average paying subscriber count. Revenue for our Christian Networks segment increased 100.6% to \$31.6 million for the year ended December 31, 2012, compared to \$15.7 million in 2011. The higher Christian Networks revenue reflects a 105.1% increase in average paying subscribers, fueled by a 113.9% increase in direct marketing investment. Revenue for the Other Networks segment decreased 23.6% to \$3.8 million for the year ended December 31, 2012, compared to \$4.9 million in 2011. The decrease in Other Networks revenue is driven by a 22.2% decrease in average paying subscribers, reflecting the elimination of inefficient online marketing expenses in 2012.

### Costs and Expenses

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses increased 42.9% to \$70.9 million for the year ended December 31, 2012, compared to \$49.6 million in 2011. The increase is primarily attributable to a \$20.3 million increase in cost of revenue.

**Cost of Revenue.** Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue increased 70.0% to \$49.2 million for the year ended December 31, 2012, compared to \$29.0 million in 2011. This increase can be primarily attributed to higher Christian Networks direct marketing expenses. Direct marketing expenses for the Christian Networks segment increased 113.9% to \$41.4 million for the year ended December 31, 2012, compared to \$19.4 million in 2011. The higher direct marketing expense reflects management's focus on increasing market share and cultivating greater brand awareness for ChristianMingle through a combination of online and offline marketing channels.

**Sales and Marketing.** Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel and consulting fees. Sales and marketing expenses increased 7.3% to \$4.0 million for the year ended December 31, 2012, compared to \$3.7 million in 2011. The increase can be primarily attributed to growth in compensation expense and public relations consulting fees. The Company increased its marketing team headcount in 2012, which led to higher compensation expense. Additionally, the Company expanded its public relations efforts which resulted in higher consulting fees.

**Customer Service.** Customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members. Customer service expenses increased 28.0% to \$2.5 million for the year ended December 31, 2012, compared to \$2.0 million in 2011. The expense increase is primarily attributed to higher compensation costs, reflecting increased support for our growing Christian Networks segment.

**Technical Operations.** Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses remained flat between fiscal years 2012 and 2011.

**Development.** Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses increased 23.5% to \$3.3 million for the year ended

December 31, 2012, compared to \$2.7 million in 2011. The increase can be attributed to higher compensation expense, consulting fees, placement fees and software licensing fees. The Company increased its development team headcount in 2012, which led to higher compensation and placement fees expense. The higher consulting and software licensing fees reflect management's focus on introducing new products to market.

General and Administrative. General and administrative expenses consist primarily of corporate personnel-related costs, professional fees, occupancy and other overhead costs. General and administrative expenses increased 8.9% to \$8.8 million for the year ended December 31, 2012, compared to \$8.1 million in 2011. The increase can be primarily attributed to higher legal expenses. In 2011, the Company received net proceeds from the settlement of a patent infringement lawsuit which reduced legal expenses.

Depreciation. Depreciation expenses consist primarily of depreciation of capitalized Web site and software development costs, computer hardware and other fixed assets. Depreciation expense increased by 26.7% to \$1.7 million for the year ended December 31, 2012, compared to \$1.3 million in 2011. Higher capitalized Web site and software development costs which started in prior years accounted for the increase in depreciation expenses.

**Amortization of Intangible Assets.** Amortization expenses consist primarily of amortization of intangible assets related to acquisitions, primarily LDSSingles and HurryDate. Amortization expense decreased 96.5% to \$13,000 for the year ended December 31, 2012, compared to \$370,000 in 2011. The decrease reflects the full amortization of the Company's intangible assets.

**Impairment of Long-lived Assets.** Impairment of long-lived assets primarily represents the write-down of investments in businesses and computer software. There was no long-lived assets impairment expense for the year ended December 31, 2012, compared to \$1.1 million in 2011. In 2011, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value.

**Interest Expense (Income) and Other, Net.** Interest expense (income) and other consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Interest expense (income) and other reflected \$238,000 of income for the year ended December 31, 2012, compared to \$162,000 of expense in 2011. The change is primarily due to non-cash foreign exchange rate fluctuations related to the intercompany loan with our Israel subsidiary.

**Provision for Income Taxes.** Provision for Income taxes for the year ended December 31, 2012 was \$6.0 million, compared to \$306,000 for the year ended December 31, 2011. The 2012 provision for income taxes consists primarily of a valuation allowance recorded against our deferred tax assets, for which we were not able to conclude that it is more likely than not it would be realized. As a result of the valuation allowance position, no tax benefit was recorded on the losses incurred for the year. The 2011 provision for income taxes relates primarily to an increase in the deferred tax liability associated with our Israeli subsidiary's tax deductible goodwill amortization and partially offset by a net tax benefit recorded on losses incurred in the US.

**Net Loss and Net Loss Per Share.** Net loss was \$15.0 million, or \$0.72 per share, for the year ended December 31, 2012, compared to a net loss of \$1.6 million or \$0.08 per share in 2011. The net loss in 2012 was primarily due to increases in Christian Networks direct marketing investments and an \$8.9 million valuation allowance against deferred tax assets.

## Quarterly Results of Operations

You should read the following tables presenting our quarterly results of operations in conjunction with the consolidated financial statements and related notes contained elsewhere in this report. We have prepared the unaudited information on substantially the same basis as our audited consolidated financial statements which, in the opinion of management, includes all adjustments, consisting only of normal recurring adjustments, except as otherwise indicated, necessary for the presentation of the results of operations for such periods. You should also keep in mind, as you read the following tables, that our operating results for any quarter are not necessarily indicative of results for any future quarters or for a full year.

	Three Months Ended							March 31, 2012
	Dec. 31, 2013	Sept. 30, 2013	June 30, 2013	March 31, 2013	Dec. 31, 2012	Sept. 30, 2012	June 30, 2012	
Consolidated Statement of Operations Data:								
Revenue	\$ 17,204	\$17,361	\$17,581	\$17,263	\$16,271	\$15,871	\$15,046	\$14,555
Cost of revenue	13,911	13,620	14,770	13,657	13,491	12,901	10,976	11,848
Sales and marketing	1,629	1,423	1,287	1,262	1,015	1,020	983	973
Customer service	765	746	688	703	647	652	622	613
Technical operations	280	288	267	332	296	362	355	350
Development	799	746	793	791	797	859	844	846
General and administrative	2,790	2,496	2,274	2,934	2,237	2,260	2,052	2,238
Depreciation	533	529	472	453	431	426	413	403
Amortization	10	10	—	—	—	—	—	13
Impairment of goodwill, long-lived assets and other assets	—	—	265	—	—	—	—	—
Total cost and expenses	20,717	19,858	20,816	20,132	18,914	18,480	16,245	17,284
Loss from operations	(3,513 )	(2,497 )	(3,235 )	(2,869 )	(2,643 )	(2,609 )	(1,199 )	(2,729 )
Interest expense (income) and other, net	(56 )	(77 )	(43 )	(53 )	(188 )	(36 )	113	(127 )
Loss before income taxes	(3,457 )	(2,420 )	(3,192 )	(2,816 )	(2,455 )	(2,573 )	(1,312 )	(2,602 )
Provision (benefit) for income taxes	92	195	84	124	8,083	(836 )	(311 )	(889 )
Net loss	\$ (3,549 )	\$ (2,615 )	\$ (3,276 )	\$ (2,940 )	\$ (10,538 )	\$ (1,737 )	\$ (1,001 )	\$ (1,713 )
Basic and diluted net loss per share <sup>1</sup>	\$ (0.15 )	\$ (0.11 )	\$ (0.15 )	\$ (0.14 )	\$ (0.51 )	\$ (0.08 )	\$ (0.05 )	\$ (0.08 )
Shares used in computation of basic and diluted net loss per share <sup>1</sup>	23,938	23,753	22,485	20,960	20,816	20,699	20,625	20,596
Average paying subscribers <sup>2</sup>	292,760	300,225	302,268	295,531	279,260	266,075	250,934	240,700
Costs and expenses include stock-based compensation as follows:								
Cost of revenue	\$—	\$—	\$—	\$—	\$2	\$2	\$2	\$2
Sales and marketing	38	36	37	34	21	17	18	20
Customer service	—	—	—	—	1	—	1	—
Technical operations	—	2	1	1	29	29	30	30
Development	—	3	3	4	11	10	10	11
General and administrative	153	153	153	149	150	138	138	141

(1) For information regarding the computation of per share amounts, refer to Note 1 of our consolidated financial statements.

(2)

Represents average paying subscribers calculated as the sum of the average paying subscribers for each month in the period, divided by the three. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two.

## Liquidity and Capital Resources

As of December 31, 2013, we had cash and cash equivalents of \$14.7 million. We have historically financed our operations with internally generated funds.

Net cash used in operations was \$7.8 million for the year ended December 31, 2013 compared to \$3.9 million for the same period in 2012. The increase in Christian Networks direct marketing accounted for the majority of change in net cash used in operations.

Net cash used in investing activities was \$3.0 million for 2013 compared to \$1.8 million for the same period in 2012. Capital expenditures for 2013 and 2012 were \$2.7 million and \$2.1 million, respectively, representing the purchase of computer hardware and capitalized software. In 2012, the Company received \$520,000 in connection with the sale of certain real property received in 2011 as a result of a legal judgment in favor of the Company.

Net cash provided by financing activities was \$15.1 million for the year ended December 31, 2013 compared to \$1.0 million for 2012. Cash provided by financing activities in 2013 was primarily related to the net proceeds received from the issuance of stock in a public offering of \$12.3 million and proceeds received from the exercise of stock options of \$2.9 million, compared to proceeds received from the exercise of stock options of \$1.1 million for the same period in 2012.

We have a \$15.0 million revolving credit facility with Bank of America, which was entered into on February 14, 2008 with subsequent amendments (the "Credit Agreement"). The Credit Agreement matures on March 14, 2016.

The per annum interest rate under the Credit Agreement is LIBOR, or the Eurodollar Rate (as defined in the Credit Agreement) under certain circumstances, plus 2.00%. In the event the Company elects to borrow under a base rate loan, the interest rate is increased to the prime rate plus 1.00%. We pay a 0.25% per annum commitment fee on all funds not utilized under the facility, measured on a daily basis.

The Credit Agreement contains financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA, minimum consolidated net liquidity and minimum consolidated revenue during different periods. The Credit Agreement also contains covenants regarding Jewish Networks minimum contribution and our ability to repurchase or redeem equity interests or issue dividends up to a specified amount, as well as other covenants, with exceptions, including restrictions on debt, liens, and investments. A default could cause any outstanding amounts to become immediately due and payable and prohibit us from obtaining further credit under the Credit Agreement.

On February 13, 2014, we executed a Sixth Amendment to the Credit Agreement (the "Sixth Amendment") changing the maturity date from February 14, 2014 to March 14, 2014. On March 11, 2014, we executed a Seventh Amendment to the Credit Agreement (the "Seventh Amendment"). The Seventh Amendment, among other things, changed the maturity date to March 14, 2016 and updated the financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA and minimum consolidated revenue during different periods.

The Company was compliant with the Credit Agreement's customary affirmative and negative covenants, as of December 31, 2013.

As of December 31, 2013, there was no outstanding amount under the Credit Agreement. In connection with the original Credit Agreement and the first five amendments thereto, the Company paid deferred financing costs of approximately \$446,000 and \$111,000, respectively. Costs associated with both the original Credit Agreement and the first five amendments thereto were included in prepaid expenses and other, and other assets. The deferred financing costs are amortized to interest (income) expense in the Consolidated Statements of Operations and Comprehensive



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Loss over the full term of the Credit Agreement. Amortization expense for the deferred financing costs for the years ended December 31, 2013 and 2012 were \$35,000 and \$25,000, respectively.

We believe that our current cash and cash equivalents, marketable securities and cash flow from operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and contractual obligations, for at least the next 12 months. We do not anticipate requiring additional capital; however, if required or desirable, we may utilize our revolving credit facility, or raise additional debt or issue additional equity in the private or public markets.

The following table describes our contractual commitments and obligations as of December 31, 2013 (in thousands):

	Less than			More than		
	1 year	1-3 years	4-5 years	5 years	Total	
Operating leases	\$ 1,029	\$ 2,429	\$ 514	\$ —	\$3,972	
Other commitments and obligations	355	338	—	—	693	
Total contractual obligations	\$ 1,384	\$ 2,767	\$ 514	\$ —	\$4,665	

37

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We had commitments and obligations consisting of operating leases, contracts with software licensing, communications, computer hosting and marketing service providers. Other commitments and obligations totaled \$355,000 for less than one year and \$338,000 for 1-3 years. Contracts with other service providers are for 30 day terms or less. For contingences related to our tax positions, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months. As a result, this amount is not included in the table above.

#### Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually, narrow or limited purposes. We do not have any outstanding derivative financial instruments, off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts.

#### Recent Accounting Developments

Effective January 1, 2013, the Company adopted Accounting Standards Update (“ASU”) No. 2013-02, “Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income”. The adoption of ASU 2013-02 concerns presentation and disclosure only, and did not have an impact on the Company’s consolidated financial position or results of operations.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Pursuant to Item 10(f) of Regulation S-K, the Company is not required to satisfy the accelerated filer disclosure requirements until the first quarter after the determination date fiscal year. As such, the Company is not required to provide the information under this item.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this Item 8 is incorporated by reference to the Index to Consolidated Financial Statements beginning at page F-1 of this annual report on Form 10-K.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

#### ITEM 9A. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the “Exchange Act.” Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2013.

Internal Control Over Financial Reporting

Annual report on internal controls over financial reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on criteria established in the framework in Internal Control — Integrated Framework ("1992 Framework") issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, the Company's management concluded that its internal control over financial reporting was effective as of December 31, 2013. The effectiveness of the Company's internal control over financial reporting as of December 31, 2013 has been audited by Ernst & Young, LLP, an independent registered public accounting firm, as stated in their report included herein.

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

Changes in internal control over financial reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Spark Networks Inc.

We have audited Spark Network, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Spark Networks, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Annual Report on Internal Controls Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Spark Networks, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Spark Networks, Inc. as of December 31, 2013 and December 31, 2012, and the related consolidated statements of operations and comprehensive loss, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2013 of Spark Networks, Inc. and our report dated March

13, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California

March 13, 2014

39

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ITEM 9B. OTHER INFORMATION

On February 13, 2014, we executed a Sixth Amendment to the Credit Agreement changing the maturity date from February 14, 2014 to March 14, 2014. On March 11, 2014, we executed a Seventh Amendment to the Credit Agreement (the "Seventh Amendment"). The Seventh Amendment, among other things, changed the maturity date to March 14, 2016 and updated the financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA and minimum consolidated revenue during different periods.

The information set forth above is included herewith for the purpose of providing the disclosure required under "Item 1.01- Entry into a Material Definitive Agreement." The foregoing description of the amendments to the Credit Agreement does not purport to be complete and is qualified in its entirety by reference to the complete terms of such amendments, copies of which are filed as Exhibits 10.11(g) and 10.11(h) to this annual report on Form 10-K and is incorporated herein by reference.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information required by this Item 10 will be included in the Proxy Statement to be filed within 120 days after the fiscal year covered by this annual report on Form 10-K and is incorporated herein by reference.

ITEM 11. EXECUTIVE  
COMPENSATION.

The information required by this Item 11 will be included in the Proxy Statement, and such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND  
RELATED STOCKHOLDER MATTERS.

The information required by this Item 12, including Equity Compensation Plan Information, will be included in the Proxy Statement, and such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this Item 13 will be included in the Proxy Statement, and such information is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this Item 14 will be included in the Proxy Statement, and such information is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) All financial statements and schedules have been omitted because they are either not applicable, not required or the information required has been disclosed in the Consolidated Financial Statements and related Notes to Consolidated Financial Statements beginning on page F-1, or otherwise included in this Form 10-K.

(a)(3) Exhibits

Exhibit Number	Description of Exhibit
3.1	Amended and Restated Certificate of Incorporation of Spark Networks, Inc. (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 7, 2010).
3.2	Certificate of Designation of Series C Preferred Stock (incorporated by reference to Exhibit 3.1(a) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
3.3(a)	Amended and Restated Bylaws effective June 7, 2010 of Spark Networks, Inc. (incorporated by reference to Exhibit 3.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 7, 2010).
3.3(b)	Amendment No. 1 to Amended and Restated Bylaws effective August 10, 2011 (incorporated by reference to Exhibit 3.1(a) of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 11, 2011).
4.1	Rights Plan Dated July 9, 2007 Between Spark Networks, Inc. and The Bank of New York (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.1(a)***	2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.1(b)***	Amendment No. 1 to the 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 6, 2009).
10.2***	Form of Stock Option Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(a) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.3***	Form of Restricted Stock Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(b) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).



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- 10.4\*\*\* Form of Restricted Stock Unit Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(c) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.5 Form of Indemnification Agreement with Officers and Directors (incorporated by reference to Exhibit 10.4 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.5(a) Schedule of Officers and Directors who entered into Indemnification Agreements.
- 10.6\*\*\* Executive Employment Agreement dated effective February 11, 2014 between Spark Networks, Inc. and Gregory R. Liberman (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 18, 2014).
- 10.7\*\*\* Stock Award Agreement dated December 16, 2013 with Gregory R. Liberman
- 10.8(a)\*\*\* Employment Agreement dated July 2, 2007 between Spark Networks plc and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.5 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.8(b)\*\*\* Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.3 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
- 10.9(a)\*\*\* Executive Employment Agreement dated May 16, 2007 between Spark Networks plc and Gregory J. Franchina (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 21, 2007).
- 10.9(b)\*\*\* Amendment No. 1, dated December 30, 2008, to Executive Employment Agreement between the Registrant and Gregory J. Franchina (incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008)

- 10.10(a)\*\*\* Executive Employment Agreement executed November 27, 2007 between Spark Networks, Inc. and Brett Zane (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 27, 2007).
- 10.10(b)\*\*\* Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Brett Zane (incorporated by reference to Exhibit 10.5 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
- 10.11(a) Credit Agreement dated February 14, 2008 among Spark Networks Limited, Spark Networks, Inc. and Bank of America, N.A. (incorporated by reference to Exhibit 10.01 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 19, 2008).
- 10.11(b) First Amendment to Credit Agreement dated as of September 29, 2009 among Spark Networks Limited, Spark Networks, Inc., Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 29, 2009).
- 10.11(c) Second Amendment to Credit Agreement dated as of February 7, 2011 among Spark Networks Limited, Spark Networks, Inc., Spark Networks USA, LLC, Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 8, 2011).
- 10.11(d) Third Amendment to Credit Agreement dated as of May 11, 2011 among Spark Networks USA, LLC, Spark Networks, Inc., and Bank of America, N.A. (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2011).
- 10.11(e) Fourth Amendment to Credit Agreement dated as of May 7, 2012 among Spark Networks, Inc., Spark Networks USA, LLC, the Subsidiary Guarantors, Bank of America, N.A. (as Administrative Agent), and the other lenders thereto (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 11, 2012).
- 10.11(f) Fifth Amendment to Credit Agreement dated as of April 25, 2013 among Spark Networks, Inc., Spark Networks USA, LLC, the Subsidiary Guarantors, Bank of America, N.A. (as Administrative Agent), and the other lenders thereto (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on April 29, 2013).
- 10.11(g) Sixth Amendment to Credit Agreement dated as of February 13, 2014 among Spark Networks, Inc., Spark Networks USA, LLC, the Subsidiary Guarantors, Bank of America, N.A. (as Administrative Agent), and the other lenders thereto
- 10.11(h) Seventh Amendment to Credit Agreement dated as of March 11, 2014 among Spark Networks, Inc., Spark Networks USA, LLC, the Subsidiary Guarantors, Bank of America, N.A. (as Administrative Agent), and the other lenders thereto.
- 10.12 Lease between the Irvine Company LLC and Spark Networks USA, LLC dated as of February 1, 2013 (incorporated by reference to Exhibit 10.18 of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 8, 2013).

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- 10.13 Underwriting Agreement, dated as of May 1, 2013, by and among Spark Networks, Inc., William Blair & Company, L.L.C. and Stifel, Nicolaus & Company, Incorporated, as representatives of the several Underwriters named in Schedule 1 thereto, and the selling stockholders named in Schedule II thereto (incorporated by reference to Exhibit 1.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 2, 2013).
- 10.14 Underwriting Agreement, dated as of November 20, 2013, by and among Spark Networks, Inc., William Blair & Company, L.L.C. and Stifel, Nicolaus & Company, Incorporated, as representatives of the several Underwriters named in Schedule I thereto, and the selling stockholders named in Schedule II thereto (incorporated by reference to Exhibit 1.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 20, 2013).
- 21.1 List of subsidiaries.
- 23.1 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm
- 31.1 Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1\* Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS\*\* XBRL Instance Document

101.SCH\*\* XBRL Taxonomy Extension Schema Document

101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF\*\* XBRL Taxonomy Extension Definition Linkbase Document

101.LAB\*\* XBRL Taxonomy Extension Label Linkbase Document

101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document

\* This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

\*\* Attached as Exhibits 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language). Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

\*\*\* Denotes a management or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 601 of Regulation S-K.

Note: Filings on Forms 10-K, 10-Q, and 8-K are under SEC File No. 001-32750.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Los Angeles, State of California, on March 13, 2014.

SPARK NETWORKS, INC.

/s/ Gregory R. Liberman  
 Gregory R. Liberman  
 Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Position	Date
/s/ Gregory R. Liberman	Chairman, Chief Executive Officer (Principal Executive Officer)	March 13, 2014
Gregory R. Liberman	President	
/s/ Brett A. Zane	Chief Financial Officer (Principal Financial Officer)	March 13, 2014
Brett A. Zane	Accounting Officer)	
/s/ Jonathan B. Bulkeley	Director	March 13, 2014
Jonathan B. Bulkeley		

/s/  
Benjamin  
Derhy      Director      March  
Benjamin      13,  
Derhy      2014

Director  
David  
Hughes

/s/ Thomas      March  
G.      13,  
Stockham      Director      2014  
Thomas G.  
Stockham

Director  
Vince  
Thompson

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Spark Networks, Inc.	
<u>Report of Ernst &amp; Young LLP, Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets at December 31, 2013 and December 31, 2012</u>	F-3
<u>Consolidated Statements of Operations and Comprehensive Loss for the years ended December 31, 2013, 2012 and 2011</u>	F-4
<u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2013, 2012 and 2011</u>	F-5
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

F-1

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Spark Networks, Inc.

We have audited the accompanying consolidated balance sheets of Spark Networks, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spark Networks, Inc. at December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Spark Networks, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated March 13, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California

March 13, 2014



## SPARK NETWORKS, INC.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except stock data)

	December 31,	
	2013	2012
Assets		
Current assets:		
Cash and cash equivalents	\$14,723	\$10,458
Restricted cash	1,296	1,232
Accounts receivable, net of allowance of \$0	1,569	1,510
Deferred tax asset – current	10	8
Prepaid expenses and other	1,787	861
Total current assets	19,385	14,069
Property and equipment, net	3,901	3,133
Goodwill	9,305	8,861
Intangible assets, net	2,269	2,143
Deferred tax asset — non-current	186	5
Deposits and other assets	208	153
Total assets	\$35,254	\$28,364
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$1,516	\$1,093
Accrued liabilities	5,761	5,339
Deferred revenue	8,830	8,128
Deferred tax liability — current portion	526	257
Total current liabilities	16,633	14,817
Deferred tax liability	1,781	1,413
Other liabilities — non-current	1,717	588
Total liabilities	20,131	16,818
Commitments and contingencies (Note 11)		
Stockholders' equity:		
10,000,000 shares of Preferred Stock, \$0.001 par value, 450,000 of which are designated as Series C Junior Participating Cumulative Preferred Stock, with no shares of Preferred Stock issued or outstanding	—	—
100,000,000 shares of Common Stock, \$0.001 par value, with 24,001,937 and 20,945,364 shares of Common Stock issued and outstanding at December 31, 2013 and 2012, respectively, at stated value of:	24	21
Additional paid-in-capital	70,747	54,857
Accumulated other comprehensive income.	776	712
Accumulated deficit	(56,424)	(44,044)
Total stockholders' equity	15,123	11,546
Total liabilities and stockholders' equity	\$35,254	\$28,364

See accompanying notes.

F-3

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## SPARK NETWORKS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except per share data)

	Years Ended December 31,		
	2013	2012	2011
Revenue	\$69,409	\$61,743	\$48,493
Cost and expenses:			
Cost of revenue (exclusive of depreciation shown separately below)	55,958	49,216	28,955
Sales and marketing	5,601	3,991	3,722
Customer service	2,902	2,534	1,980
Technical operations	1,167	1,363	1,367
Development	3,129	3,346	2,710
General and administrative	10,494	8,787	8,068
Depreciation	1,987	1,673	1,320
Amortization of intangible assets other than goodwill	20	13	370
Impairment of goodwill, long-lived assets and other assets	265	0	1,145
Total cost and expenses	81,523	70,923	49,637
Operating loss	(12,114)	(9,180 )	(1,144 )
Interest (income) expense and other, net	(229 )	(238 )	162
Loss before income taxes	(11,885)	(8,942 )	(1,306 )
Provision for income taxes	495	6,047	305
Net loss	\$(12,380)	\$(14,989)	\$(1,611 )
Net loss per share—basic and diluted	\$(0.54 )	\$(0.72 )	\$(0.08 )
Weighted average shares outstanding—basic and diluted	22,795	20,781	20,591
Other comprehensive loss, net of tax:			
Foreign currency translation adjustments	\$64	\$40	\$(101 )
Total other comprehensive income (loss), net of tax	64	40	(101 )
Comprehensive loss	\$(12,316)	\$(14,949)	\$(1,712 )

Stock-Based Compensation (in thousands)	Years Ended December 31,		
	2013	2012	2011
Cost of revenue	\$ —	\$ 8	\$ 8
Sales and marketing	145	76	80
Customer service	—	2	—
Technical operations	4	118	119
Development	10	42	42
General and administrative	608	567	657

See accompanying notes.

F-4

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## SPARK NETWORKS, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income		Total Accumulated Stockholders' Equity
	Shares	Amount		Deficit		
BALANCE, December 31, 2010	20,587	\$ 21	\$ 52,020	\$ 773	\$ (27,444 )	\$ 25,370
Issuance of common stock upon exercise of stock options	8	—	21	—	—	21
Excess tax benefits from stock-based comp	—	—	67	—	—	67
Foreign currency translation adjustments, net of tax	—	—	0	(101 )	—	(101 )
Stock-based compensation	—	—	906	—	—	906
Net loss	—	—	—	—	(1,611 )	(1,611 )
BALANCE, December 31, 2011	20,595	\$ 21	\$ 53,014	\$ 672	\$ (29,055 )	\$ 24,652
Issuance of common stock upon exercise of stock options	350	—	1,053	—	—	1,053
Excess tax provisions from stock-based comp	—	—	(23 )	—	—	(23 )
Foreign currency translation adjustments, net of tax	—	—	—	40	—	40
Stock-based compensation	—	—	813	—	—	813
Net loss	—	—	—	—	(14,989 )	(14,989 )
BALANCE, December 31, 2012	20,945	\$ 21	\$ 54,857	\$ 712	\$ (44,044 )	\$ 11,546
Issuance of common stock upon exercise of stock options	916	1	2,872	—	—	2,873
Issuance of common stock in a public offering	2,141	2	12,251	—	—	12,253
Foreign currency translation adjustments, net of tax	—	—	—	64	—	64
Stock-based compensation	—	—	767	—	—	767
Net loss	—	—	—	—	(12,380 )	(12,380 )
BALANCE, December 31, 2013	24,002	\$ 24	\$ 70,747	\$ 776	\$ (56,424 )	\$ 15,123

See accompanying notes.

F-5

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## SPARK NETWORKS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net loss	\$(12,380)	\$(14,989)	\$(1,611)
Adjustments to reconcile net loss to cash (used in) provided by operating activities:			
Depreciation and amortization	2,007	1,686	1,690
Impairment of goodwill, long-lived assets and other assets	265	—	1,145
Stock-based compensation	767	813	906
Non-current taxes payable and other	12	(534)	96
Foreign exchange (gain) loss on intercompany loan	(297)	(124)	337
Income from asset received from legal judgment	—	(151)	(247)
Excess tax benefits (provisions) from stock-based compensation	—	23	(67)
Deferred taxes	454	5,897	(96)
Changes in operating assets and liabilities:			
Accounts receivable, net	(59)	(364)	(299)
Restricted cash	(64)	(274)	38
Prepaid expenses and other assets	(258)	336	(128)
Accounts payable and accrued liabilities	782	1,414	(100)
Deferred revenue	702	2,405	1,392
Other liabilities	255	—	—
Net cash (used in) provided by operating activities	(7,814)	(3,862)	3,056
Cash flows from investing activities:			
Sales of property and equipment	—	520	—
Purchases of property and equipment	(2,689)	(2,081)	(1,583)
Purchases of businesses and intangible assets	(358)	(255)	(356)
Net cash used in investing activities	(3,047)	(1,816)	(1,939)
Cash flows from financing activities:			
Proceeds from issuance of stock in a public offering	12,253	—	—
Proceeds from issuance of stock from exercise of stock options	2,873	1,053	21
Excess tax (provision) benefit from stock-based compensation	—	(23)	67
Net cash provided by financing activities	15,126	1,030	88
Net increase (decrease) in cash	4,265	(4,648)	1,205
Cash and cash equivalents at beginning of year	10,458	15,106	13,901
Cash and cash equivalents at end of year	\$ 14,723	\$ 10,458	\$ 15,106
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	\$61	\$45	\$192

See accompanying notes.

F-6

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Summary of Significant Accounting Policies

The Company

The common stock of Spark Networks, Inc., a Delaware corporation (the “Company”), is traded on the NYSE MKT.

On December 31, 2010, Spark Networks Limited (“SNUK”) distributed its shareholdings in each of HurryDate, LLC; MingleMatch, Inc.; Kizmeet, Inc.; SN Holdco, LLC; SN Events, Inc.; Reseaux Spark Canada Ltd. and Spark SocialNet, Inc. by transferring its shares in those companies to Spark Networks, Inc. Spark Networks, Inc. subsequently transferred all of its shares in the same companies to LOV USA, LLC, a newly formed and wholly owned subsidiary of Spark Networks, Inc. SNUK continues to hold all of the shares of Spark Networks (Israel) Limited and JDate Limited. In addition, SNUK now holds all of the shares of Spark Networks USA, LLC, a newly formed subsidiary into which SNUK has transferred all of its United States based assets.

The Company and its consolidated subsidiaries provide online personals services in the United States and internationally, whereby adults are able to post information about themselves (“profiles”) on the Company’s Web sites and search and contact other individuals who have posted profiles.

Membership to the Company’s online services, which includes the posting of a personal profile and photos, and access to its database of profiles, is free. The Company typically charges a subscription fee for varying subscription lengths (typically, one, three, six and twelve months) to members, allowing them to initiate communication with other members and subscribers utilizing the Company’s onsite communication tools, including anonymous email, instant messenger, chat rooms and message boards. For most of the Company’s services, two-way communications through the Company’s email platform can only take place between paying subscribers.

The Company has evaluated all subsequent events through the date the consolidated financial statements were issued.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the parent Company and all of its majority-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The financial statements of the Company’s foreign subsidiaries are prepared using the local currency as the subsidiary’s functional currency. The Company translates the assets and liabilities using period-end rates of exchange, and revenue and expenses using average rates of exchange for the year. The resulting translation gain or loss is included in accumulated other comprehensive loss and is excluded from net loss.

The nature of the intercompany loan between the Company and its Israel subsidiary is classified as a loan which the Company expects to be settled. The foreign exchange gains and losses related to this loan are recorded as part of net loss and excluded from accumulated other comprehensive loss. For the years ended December 31, 2013 and 2012, the Company recorded a foreign exchange loss of \$297,000 and \$124,000, respectively, related to the intercompany loan.

## Revenue Recognition and Deferred Revenue

Substantially all of the Company's revenue is derived from subscription fees. Revenue is presented net of credits and credit card chargebacks. The Company recognizes revenue in accordance with accounting principles generally accepted in the United States. Revenue recognition occurs ratably over the subscription period, beginning when there is persuasive evidence of an arrangement, delivery has occurred (access has been granted), the fees are fixed or determinable, and collection is reasonably assured. Subscribers pay in advance, primarily by using a credit card, and, subject to certain conditions identified in our terms and conditions, all purchases are final and nonrefundable. Fees collected in advance for subscriptions are deferred and recognized as revenue using the straight line method over the term of the subscription.

The Company also earns a small amount of revenue from advertising sales and offline events. The Company records advertising revenue as it is earned and is included in the total revenue of each segment that generates advertising sales. Revenue and the related expenses associated with offline events are recognized at the conclusion of each event.

F-7

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### Fair Value Measurement

Fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2—Other inputs that are directly or indirectly observable in the marketplace.

Level 3—Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As of December 31, 2013 and 2012, the Company had financial assets that consisted of cash and cash equivalents, which were measured at fair value using quoted prices for identical assets in an active market (Level 1 fair value hierarchy) in accordance with the latest guidance.

### Cash and Cash Equivalents

All highly liquid instruments with an original maturity of three months or less are considered cash and cash equivalents.

### Restricted Cash

The Company's credit card processors regularly withhold deposits and maintain balances which the Company records as restricted cash. As of December 31, 2013 and 2012, the Company had \$1.3 million and \$1.2 million in restricted cash, respectively.

### Accounts Receivable

Accounts receivable is primarily composed of credit card payments for subscription fees, less amounts withheld and presented as restricted cash, pending collection from the credit card processors and to a much smaller extent, receivables for advertising sales. The Company reviews its accounts receivable from advertisers on a monthly basis to determine if an allowance is necessary. An allowance was not necessary as of December 31, 2013 or 2012.

### Prepaid Advertising Expenses

In certain circumstances, the Company pays in advance for advertising and expenses the prepaid amounts over the contract periods as the vendors deliver on their commitments. The Company evaluates the realization of prepaid amounts at each reporting period, and expenses prepaid amounts upon delivery of services or if it determines that a vendor will be unable to deliver on its commitment and is not willing or able to repay the undelivered prepaid amount.

### Web Site and Software Development Costs

The Company capitalizes costs related to developing or obtaining internal-use software. Capitalization of costs begins after the preliminary project stage has been completed. Product development costs are expensed as incurred or capitalized into property and equipment. Costs incurred in the preliminary project and post-implementation stages of an internal use software project are expensed as incurred and certain costs incurred in the application development stage of a project are capitalized.

In accordance with the “Accounting for Web Site Development Costs” guidance, the Company expenses costs related to the planning and post implementation phases of Web site development efforts. Direct costs incurred in the development phase are capitalized. Costs associated with minor enhancements and maintenance for a Web site are included in expenses in the accompanying Consolidated Statements of Operations And Comprehensive Loss.

F-8

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Capitalized Web site and internal software development costs are recorded under property and equipment and amortized over the estimated useful life of the products, which is usually three years. The following table summarizes capitalized software development costs for the years ended December 31, (in thousands):

	2013	2012	2011
Capitalized	\$ 1,849	\$ 1,641	\$1,250
Expensed	(1,364)	(1,186)	(850 )
Impaired	(265 )	—	(45 )
Unamortized Balance	\$ 2,651	\$ 2,431	\$1,976

#### Property and Equipment

Property and equipment is stated at cost, net of accumulated depreciation, which is provided using the straight-line method over the estimated useful life of the asset. Amortization of leasehold improvements is calculated using the straight-line method over the estimated useful life of the asset or remaining term of the lease, whichever is shorter. Upon the sale or retirement of property or equipment, the cost and related accumulated depreciation and amortization are removed from the Company's Balance Sheet with the resulting gain or loss, if any, reflected in the Company's Consolidated Statements of Operations and Comprehensive Loss.

#### Goodwill and Indefinite Lived Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired resulting from business acquisitions, specifically allocated to reporting units. Intangible assets resulting from the acquisitions of entities are recorded using the purchase method of accounting and estimated by management based on the fair value of assets received. Identifiable intangible assets are comprised mainly of domain names and acquired technologies. Domain names were determined to have indefinite useful lives, thus, they are not amortized. Intangible assets with finite useful lives are amortized using the straight-line method over their estimated useful lives. In addition to the recoverability assessment, the Company routinely reviews the remaining estimated useful lives of its amortizable intangible assets. If the Company reduces its estimate of the useful life assumption for any asset, the remaining unamortized balance would be amortized or depreciated over the revised estimated useful life. The Company determines its reporting units and operating segments through the use of the management approach. The management approach considers the internal organizational structure used by the Company's chief operating decision maker for making operating decisions and assessing performance.

The Company reviews the potential of impairment of goodwill at least annually or more frequently if events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable. The Company has elected to first assess the qualitative factors to determine whether it is more likely than not that the fair value of its reporting units is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment under Accounting Standards Update ("ASU") No. 2011-08 "Goodwill and Other (Topic 350): Testing Goodwill for Impairment" issued by the Financial Accounting Standards Board ("FASB"). If the Company determines that it is more likely than not that its fair value of its reporting units is less than their respective carrying amount, then the two-step goodwill impairment test is performed. The first step, identifying a potential impairment, compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, the second step would need to be performed; otherwise, no further step is required. The second step, measuring the impairment loss, compares the implied fair value of the goodwill with the carrying amount of the goodwill. Any excess of the goodwill carrying amount over the applied fair value is recognized as an impairment loss, and the carrying value of goodwill is written down to fair value. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices

or appraised values, depending on the nature of the assets. The valuation of goodwill and indefinite lived intangible assets incorporates significant Level 3 unobservable inputs and requires estimates, including the amount and timing of future cash flows. As of December 31, 2013, no impairment of goodwill or intangible assets had been identified. As of December 31, 2013 and 2012, the Company had unamortized goodwill of approximately \$9.3 million and \$8.9 million, respectively.

#### Impairment of Long-lived Assets

The Company assesses the impairment of assets, which include property and equipment and identifiable intangible assets, whenever events or changes in circumstances indicate that such assets might be impaired and the carrying value may not be recoverable. Events and circumstances that may indicate that an asset is impaired may include significant decreases in the market value of an asset or common stock, a significant decline in actual and projected revenue, a change in the extent or manner in which an asset is used, shifts in technology, loss of key management or personnel, changes in the Company's operating model or strategy and competitive forces, as well as other factors.

F-9

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If events and circumstances indicate that the carrying amount of an asset may not be recoverable and the expected undiscounted future cash flows attributable to the asset are less than the carrying amount of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices or appraised values, depending on the nature of the assets. Fair value measurements utilized for assets under non-recurring measurements were measured with Level 3 unobservable inputs.

In 2013, the Company impaired capitalized software development costs of approximately \$265,000 related to certain web-based products that failed to perform to Company standards. There were no impairment charges in 2012.

#### Income Taxes

The Company accounts for income taxes under the asset and liability method. Accordingly, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are established when necessary to reduce deferred taxes to the amount expected to be realized.

In assessing the potential realization of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the Company's tax loss carry-forwards remain deductible.

The Company operates in multiple taxing jurisdictions, both within the United States and outside the United States. The Company has filed tax returns with positions that may be challenged by Federal and State tax authorities. These positions relate to, among others, transfer pricing, the deductibility of certain expenses, intercompany transactions as well as other matters. Although the outcome of tax audits is uncertain, the Company regularly assesses its tax position for such matters and, in management's opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. To the extent reserves are recorded, they will be utilized or reversed once the statute of limitations has expired and/or at the conclusion of the tax examination. The Company believes that the ultimate outcome of these matters will not have a material impact on its financial position or liquidity. The Company recognizes the tax effects from an uncertain tax position in our consolidated financial statements, only if the position is more-likely-than-not of being sustained on audit, based on the technical merits of the position. Tax positions that meet the recognition threshold are reported at the largest amount that is more-likely-than-not to be realized.

#### Cost of Revenue

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Direct marketing costs are expensed in the period incurred and primarily represent online marketing, including payments to search engines and affiliates, and offline marketing, including radio, billboard, television and print advertising. For the years ended December 31, 2013, 2012 and 2011, the Company incurred direct marketing costs amounting to approximately \$52.1 million, \$45.7 million and \$25.7 million, respectively.

#### Sales and Marketing

The Company's sales and marketing expenses relate primarily to salaries for sales and marketing personnel and other associated costs such as business development, consulting, public relations and expenses related to the Company's

travel and events business.

#### Customer Service

The Company's customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members.

#### Technical Operations

The Company's technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements.

F-10

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## Development

The Company's development expenses relate primarily to salaries and wages for personnel involved in the development, enhancement and maintenance of its Web sites and services.

## General and Administrative

The Company's general and administrative expenses relate primarily to salaries and wages for corporate personnel, professional fees, occupancy and other overhead costs.

## Stock-based Compensation

Prior to 2005, the Company did not record tax benefits of deductions resulting from the exercise of share options due to the uncertainty surrounding the timing of realizing the benefits of its deferred tax assets in future tax returns. Cash flows resulting from tax benefits associated with tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) is classified as cash flows from financing activities.

The following is a chart showing variables which were used in the Black-Scholes option-pricing model for the years of:

	2013	2012	2011
Expected life in years	4.56-4.75	4.27-5.77	4.56
Dividend per share	—	—	—
Volatility	35.0-43.0%	35.0 %	35.0-45.0%
Risk-free interest rate	1.0 %	1.0-1.75 %	1.4-3.0 %

The Company used historical and empirical data to assess different forfeiture rates for three different groups of employees. The Company must reassess forfeiture rates when deemed necessary and it must calibrate actual forfeiture behavior to what has already been recorded. For 2013, 2012 and 2011, there were three groups of employees whose behavior was significantly different from each other. Therefore, the Company estimated different forfeiture rates for each group.

The volatility rate was derived by examining historical stock price behavior and assessing management's expectations of stock price behavior during the term of the option.

Due to the re-pricing of most options in 2009 and limited option exercise history, the Company is using the "simplified method" calculation, to determine the term of the options. The "simplified method" calculation derives the term by averaging the vesting term with the contractual terms. Option awards to date have generally vested and been expensed in equal annual installments over a four-year period. The "simplified method" allows companies that do not have sufficient historical experience to provide a reasonable basis for an estimate to instead estimate the expected term of a "plain vanilla" option by averaging the time to vesting and the full term of the option. ("Plain vanilla" options are options with the following characteristics: (1) the options are granted at-the-money; (2) exercisability is conditional only upon performing service through the vesting date; (3) if an employee terminates service prior to vesting, the employee would forfeit the options; (4) if an employee terminates service after vesting, the employee would have a limited time to exercise the options (typically 30 to 90 days); and (5) the options are nontransferable and non-hedgeable.) The Company periodically evaluates the applicability of using the simplified method with respect to the characteristics noted above with respect to the Company's options and will continue to do so as the business continues to evolve.

The risk free interest rates are based on U.S Treasury zero-coupon bonds with similar terms for the periods in which the options were granted.

#### Comprehensive Loss

Comprehensive loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For the Company, comprehensive loss consists of its reported net loss and foreign currency translation adjustments, net of tax, for the years 2013, 2012 and 2011.

#### Fair Value of Financial Instruments

The Company's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, prepaid expenses and other, accounts payable and accrued liabilities are carried at cost, which approximates their fair value due to the short-term maturity of these instruments.

F-11

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## Net Loss Per Share

The Company calculates and presents the net loss per share on both a basic and diluted basis. Basic net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of shares of common stock outstanding.

	For the Year Ended December 31		
	(in thousands except per share amounts)		
	2013	2012	2011
Net Loss Per Common Share — Basic and Diluted			
Net loss applicable to common stock	\$ (12,380 )	\$ (14,989 )	\$ (1,611 )
Weighted average shares outstanding- basic and diluted	22,795	20,781	20,591
Net Loss Per Share – Basic and Diluted	\$ (0.54 )	\$ (0.72 )	\$ (0.08 )

Options to purchase 3.0 million, 3.8 million and 3.5 million shares for fiscal years 2013, 2012 and 2011, respectively, were not included in the computation of diluted net loss per share because the options were anti-dilutive.

## Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company estimates the amount of chargebacks that will occur in future periods to offset current revenue. The Company's revenue is collected through online credit card transactions. As such, the Company is subject to revenue reversals or "chargebacks" by consumers generally up to 90 days subsequent to the original sale date. The Company accrues chargebacks based on historical trends relative to sales levels by Web site. Fines are levied by the major credit card companies when chargeback expenses exceed certain thresholds. The Company estimates fines based on discussions with its merchant processing companies combined with standard fine schedules provided by the major credit card companies.

## Recent Accounting Developments

In July 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". ASU No. 2013-11 provides that a liability related to an unrecognized tax benefit ("UTB") should be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or tax credit carryforward if such settlement is required or expected in the event that the UTB is disallowed. The Company adopted ASU No. 2013 on January 1, 2014, however, it is not expected that such adoption will have a material impact on the Company's consolidated financial position or results of operations.

2. Income Taxes

Loss before income taxes: (in thousands)	Year Ended December 31,		
	2013	2012	2011
U.S.	\$(11,597)	\$(8,984)	\$(619 )
Foreign	(288 )	42	(687 )
	\$(11,885)	\$(8,942)	\$(1,306)

Income tax expense: (in thousands)	Year Ended December 31,		
	2013	2012	2011
<b>Current</b>			
Federal	\$2	\$(22 )	\$(326)
State	100	143	638
Foreign	49	45	69
	151	166	381
<b>Deferred</b>			
Federal	(3,803)	(3,121)	50
State	(552 )	95	(160)
Foreign	(25 )	5	477
	(4,380)	(3,021)	367
Change in valuation allowance	4,724	8,902	(443)
	\$495	\$6,047	\$305

Reconciliation of effective income tax rate:	Year Ended December 31,		
	2013	2012	2011
Provision on earnings at federal statutory rate	(34.0)%	(34.0 )%	(34.0)%
State tax (benefit) provision, net of federal (benefit) provision	(0.8 )	(1.1 )	6.0
Nondeductible expenses	(0.3 )	—	0.3
Tax reserves	0.5	2.2	(1.3 )
Change in effective tax rates	0.8	1.7	18.6
Foreign tax rate differential	0.3	0.3	9.6
Valuation allowance	39.7	100.0	(8.9 )
Write down of deferred tax asset	—	—	34.1
Other	(2.0 )	(1.1 )	(1.1 )
Total provision for income taxes	4.2 %	68.0 %	23.3 %

The Company's effective tax rate was also impacted by income taxes incurred in foreign and state jurisdictions. With respect to the income of its foreign subsidiary, the Company takes the position that the earnings of the foreign subsidiary are permanently invested in that jurisdiction. As a result, no additional income taxes have been provided on the possible repatriation of these earnings to the parent company. The Company has not calculated the amount of the deferred tax liability that would result from such repatriation as such determination is not practicable.

The components of the deferred income tax asset (liability) for the periods presented are as follows:

(in thousands)	Year Ended December 31,		
	2013	2012	2011
Deferred income tax assets			
Net operating loss carry-forward	\$ 10,253	\$ 4,506	\$ 782
Depreciation and amortization	905	1,358	1,655
Compensation accruals	1,655	2,236	2,590
Credits	892	899	913
Other	840	573	496
Total before valuation allowance	14,545	9,572	6,436
Less: Valuation allowance	(14,368)	(9,568)	(649 )
Total deferred income tax assets	177	4	5,787
Deferred income tax liabilities			
Foreign intangible assets	(1,772 )	(1,401 )	(1,205 )
Other	(517 )	(260 )	(319 )
Total deferred income tax liabilities	(2,289 )	(1,661 )	(1,524 )
Total net deferred income tax	\$ (2,112 )	\$ (1,657)	\$ 4,263

As of December 31, 2013, the Company has a valuation allowance against its deferred tax assets of approximately \$14.4 million. Companies are required to assess whether a valuation allowance should be recorded against their deferred tax assets (“DTAs”) based on the consideration of all available evidence, using a “more likely than not” realization standard. In accordance with ASC 740, cumulative losses in recent years, which the Company defines as the most recent three year period, is considered significant negative evidence in evaluating the realizability of DTAs, that is difficult to overcome. In light of the Company’s recent history of losses, it is not able to conclude that it is more likely than not that its DTAs will be realized and it recorded a valuation allowance against its DTAs, with a corresponding charge to the income tax provision, of approximately \$4.7 million as of December 31, 2013.

At December 31, 2013, the Company has gross net operating loss carry-forwards for income tax purposes of approximately \$34.7 million and \$45.7 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2025 for federal purposes and 2018 for state purposes. Under Section 382 of the Internal Revenue Code, the utilization of the net operating loss carry-forwards may be limited based on changes in the percentage ownership of the Company.

At December 31, 2013, the Company also has net operating loss carryovers for Israeli tax purposes of approximately \$4.1 million which do not expire.

At December 31, 2013, the Company has federal income tax credit carry-forwards for income tax purposes of approximately \$900,000 available to reduce future federal income tax.

The Company recognizes excess tax benefits associated with the exercise of stock options directly to stockholders’ equity only when realized. Accordingly, deferred tax assets are not recognized for net operating losses resulting from excess tax benefits. As of December 31, 2013, deferred tax assets do not include approximately \$5.3 million of these excess tax benefits from employee stock option exercises that are a component of the Company’s net operating loss carry forwards. Accordingly, additional paid-in-capital will be increased up to an additional \$5.3 million if and when such excess tax benefits are realized. However, to the extent additional paid-in capital has been recognized for

qualifying excess tax deductions from previous share-based payments, the write-off of the deferred tax asset when the tax deduction is less than recognized compensation cost is charged to additional paid-in capital, with any remainder charged to provision for income taxes.

The following table summarizes the activity related to our unrecognized tax positions:

(in thousands)	2013	2012	2011
Balance at beginning of year	\$ 1,225	\$975	\$839
Additions for tax positions of prior years	—	250	463
Reductions for tax positions of prior years	—	—	(327)
Balance at end of year	\$ 1,225	\$1,225	\$975

Included in the unrecognized tax benefits of \$1.2 million at December 31, 2013 was \$900,000 of tax, if recognized, would reduce our annual effective tax rate.

The Company's policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax (benefit) provision.

As of December 31, 2013 and 2012, the Company had recorded a \$305,000 and \$216,000 accrual for interest and penalties on unrecognized tax benefits, respectively. Interest expense (income) of \$89,000, \$51,000 and (\$31,000) were recognized in the years ended December 31, 2013, 2012 and 2011, respectively. It is reasonably possible that the unrecognized tax benefits decreases by approximately \$700,000 over the next 12 months.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years before 2010; state and local income tax examinations before 2009; and foreign income tax examinations before 2009. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carry forward amount.

### 3. Property and Equipment

Property and equipment consists of the following:

(in thousands)	As of December 31,	
	2013	2012
Computer equipment	\$2,222	\$2,083
Computer software	7,674	6,060
Furniture, fixtures and equipment	625	694
Leasehold improvements	501	667
	11,022	9,504
Less: Accumulated depreciation	(7,121 )	(6,371 )
	\$3,901	\$3,133

Depreciation expense, for the years ended December 31, 2013 and 2012, was \$2.0 million and \$1.7 million, respectively, and is calculated on the straight-line basis over three years.

### 4. Goodwill and Other Intangible Assets

#### Goodwill

Goodwill as of December 31, 2013 and 2012 is related to the purchase of Pointmatch in January 2004, MingleMatch, Inc. in May 2005, and LDSSingles in May 2006. Jewish Networks, Christian Networks and Other Networks are the reporting units with goodwill balances. Jewish Networks goodwill balance at December 31, 2013 and 2012 was \$7.4 million. Christian Networks goodwill balance at December 31, 2013 and 2012 was \$1.7 million. Other Networks goodwill balance at December 31, 2013 and 2012 was \$232,000. The following table shows the activity and balances related to goodwill from January 1, 2012 to December 31, 2013:

(in thousands)	Gross Goodwill	Accumulated Impairments	Net Goodwill
Balance at January 1, 2012	22,417	(13,734 )	8,683
Foreign currency translation adjustments	178 <sup>(1)</sup>	—	178 <sup>(1)</sup>
Balance at December 31, 2012	\$ 22,595	\$ (13,734 )	\$ 8,861
Foreign currency translation adjustments	444 <sup>(1)</sup>	—	444 <sup>(1)</sup>
Balance at December 31, 2013	\$ 23,039	\$ (13,734 )	\$ 9,305

(1) Foreign currency translation adjustments related to the Jewish Networks reporting unit.

In 2013 and 2012, the Company performed its annual impairment analysis utilizing the qualitative assessment option. Qualitative factors were assessed to determine whether it was necessary to perform the two-step test (quantitative assessment). The analysis concluded that it is more-likely-than-not that the fair values of the Jewish Networks, Christian Networks and Other Networks exceeded their carrying values. At the conclusion of the analysis, it was determined that impairment was not warranted for either year.



In 2011, the Company performed its annual impairment analysis utilizing a quantitative assessment. The fair value of the reporting units was estimated based on the market approach and income approach. The income approach relies upon discounted future cash flows which are derived from various assumptions including: projected cash flows, discount rates, projected long-term growth rates and terminal values. The Company used a discount rate which reflects the risks and uncertainty related to each reporting unit. The analysis concluded that the estimated reporting units' fair values exceeded their carrying values. At the conclusion of the analysis, it was determined that impairment was not warranted.

#### Other Intangibles

Finite-lived intangible assets consist of purchased technologies and non-compete agreements which are amortized over their expected periods of benefits (ranging from three to five years). Indefinite-lived intangible assets, consist of purchased domain names and are not amortized. Other intangible assets consist of the following:

(in thousands)	As of December 31, 2013		As of December 31, 2012	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Purchased technologies	\$ 1,200	\$ (1,200 )	\$ 1,200	\$ (1,200 )
Non-compete	120	(20 )	—	—
Domain names	2,169	—	2,143	—
	\$ 3,489	\$ (1,220 )	\$ 3,343	\$ (1,200 )

Amortization expense for finite-lived intangible assets for the years ended December 31, 2013 and 2012 was \$20,000 and \$13,000, respectively. In 2013 and 2012, no impairment charge was necessary.

#### 5. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31,	
	2013	2012
	(in thousands)	
Advertising	\$ 1,685	\$ 1,789
Compensation	1,715	1,882
Other	2,361	1,668
Total	\$ 5,761	\$ 5,339

#### 6. Income on Possession of Assets

In 2011, the Company became the record title owner of real property purchased in a sheriff's sale to partially satisfy the Company's outstanding judgment against Will Knedlik.

On June 15, 2012, the Company sold the real property. Based upon the net proceeds of the transaction, the Company realized a total gain of \$398,000, with \$247,000 of the gain being recognized in 2011 and \$151,000 upon the sale of the real property in 2012.

#### 7. Revolving Credit Facility

The Company and its wholly-owned subsidiary, Spark Networks USA, LLC, have a \$15.0 million revolving credit facility with Bank of America, which was entered into on February 14, 2008 with subsequent amendments (the "Credit Agreement"). The Credit Agreement matures on March 14, 2016.

The per annum interest rate under the Credit Agreement is LIBOR, or the Eurodollar Rate (as defined in the Credit Agreement) under certain circumstances, plus 2.00%. In the event the Company elects to borrow under a base rate loan, the interest rate is increased to the prime rate plus 1.00%. The Company pays a 0.25% per annum commitment fee on all funds not utilized under the facility, measured on a daily basis.

The Credit Agreement contains financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA, minimum consolidated net liquidity and minimum consolidated revenue during different periods. The Credit Agreement also contains covenants regarding Jewish Networks minimum contribution and the Company's ability to repurchase or redeem equity interests or issue dividends up to a specified amount, as well as other covenants, with exceptions, including restrictions on debt, liens, and investments. A default could cause any outstanding amounts to become immediately due and payable and prohibit the Company from obtaining further credit under the Credit Agreement.

On February 13, 2014, the parties executed a Sixth Amendment to the Credit Agreement (the "Sixth Amendment") changing the maturity date from February 14, 2014 to March 14, 2014. On March 11, 2014, the parties executed a Seventh Amendment to the Credit Agreement (the "Seventh Amendment"). The Seventh Amendment, among other things, changed the maturity date to March 14, 2016 and updated the financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA and minimum consolidated revenue during different periods. The Company was compliant with the Credit Agreement's customary affirmative and negative covenants, as of December 31, 2013.

As of December 31, 2013, there was no outstanding amount under the Credit Agreement. In connection with the original Credit Agreement and the first five amendments thereto, the Company paid deferred financing costs of approximately \$446,000 and \$111,000, respectively. Costs associated with both the original Credit Agreement and the first five amendments thereto were included in prepaid expenses and other, and other assets. The deferred financing costs are amortized to interest (income) expense in the Consolidated Statements of Operations and Comprehensive Loss over the full term of the Credit Agreement. Amortization expense for the deferred financing costs for the years ended December 31, 2013 and December 31, 2012 were \$35,000 and \$25,000, respectively.

## 8. Stockholders' Equity

On December 12, 2013, the Company's Board of Directors authorized the repurchase of up to \$5.0 million of the Company's common stock. The repurchases may be made from time to time in the open market, in privately negotiated transactions, or otherwise, including pursuant to a Rule 10b5-1 plan, at prices that the Company deems appropriate and subject to market conditions, applicable law, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended, and other factors deemed relevant in the Company's sole discretion. The Company is not obligated to repurchase any dollar amount or any number of shares of common stock, and the program may be suspended, discontinued or modified at any time, for any reason and without notice.

On May 7, 2013, the Company issued 2,140,000 shares of its common stock at \$6.25 per share in an underwritten public offering. The proceeds to the Company, net of \$1.1 million of underwriting fees and offering expenses, were \$12.3 million.

## Employee Stock Option Plans

On July 9, 2007, pursuant to the completion of the Scheme of Arrangement, the Company adopted the Spark Networks, Inc. 2007 Omnibus Incentive Plan (the "2007 Plan") authorizing and reserving 2.5 million options. In connection with the Company's Scheme of Arrangement, the 2004 Share Option Plan was frozen; however, all outstanding options previously granted thereunder continue in full force and effect.

Awards under the 2007 Plan may include incentive stock options, nonqualified stock options, stock appreciation rights ("SARs"), restricted shares of common stock, restricted stock units, performance stock or unit awards, other stock-based

awards and cash-based incentive awards.

The Compensation Committee may grant an award to a participant. The terms and conditions of the award, including the quantity, price, vesting periods and other conditions on exercise will be determined by the Compensation Committee.

The exercise price for stock options will be determined by the Compensation Committee in its discretion, but may not be less than 100% of the closing sale price of one share of the Company's common stock on the NYSE MKT (or any other applicable exchange on which the stock is listed) on the date when the stock option is granted. Additionally, in the case of incentive stock options granted to a holder of more than 10% of the total combined voting power of all classes of stock of the Company on the date of grant, the exercise price may not be less than 110% of the closing sale price of one share of common stock on the date the stock option is granted.

F-17

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As of December 31, 2013, total unrecognized compensation cost related to non-vested stock options was \$1.2 million. This cost is expected to be recognized over a weighted-average period of 3 years. The following table describes option activity for the years ended December 31, 2013, 2012 and 2011:

	Years Ended December 31,		
	2013	2012	2011
Granted, weighted average fair value per share	\$2.28	\$2.02	\$1.02
Exercised, weighted average intrinsic value per share	\$4.55	\$2.89	\$0.32
Aggregate intrinsic value of options outstanding and exercisable (in thousands)	\$6,093	\$12,614	\$1,571

Information relating to outstanding stock options is as follows (in thousands, except Weighted Average Price per Share):

	Number of Shares	Weighted Average Price per Share
Outstanding at December 31, 2011	3,583	\$ 3.14
Granted	665	7.36
Exercised	(350 )	3.00
Expired	(12 )	4.38
Forfeited	(57 )	3.15
Outstanding at December 31, 2012	3,829	\$ 3.88
Granted	152	7.32
Exercised	(951 )	3.30
Expired	(5 )	3.00
Forfeited	(73 )	7.63
Outstanding at December 31, 2013	2,952	\$ 4.19

Option Range Summary

As of December 31, 2013

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price
\$3.18 - \$10.00	1,476	5.75	\$ 5.45	850	4.92	\$ 4.40
\$3.00	1,372	4.11	\$ 3.00	1,335	4.12	\$ 3.00
\$2.18 - \$2.99	103	2.55	\$ 2.50	103	2.55	\$ 2.50
	2,952	3.61	\$ 4.19	2,288	3.02	\$ 3.50

Options granted prior to 2006, were priced in foreign currency, weighted average price per share calculations are impacted by foreign currency exchange fluctuations.

Re-Pricing of Employees Options

In 2009, the Company offered to re-price options for certain employees. These employees could surrender their existing options in exchange for a like number of options with a new grant date, a lower exercise price, a lower number of vested options and a modified vesting schedule. The exchange of options was treated as a synthetic re-pricing, which includes a cancellation and replacement of equity instruments. The incremental expense was approximately \$1.0 million and is being recognized over the four year vesting term of the newly issued options. The incremental expenses recognized for the years ended December 31, 2013, 2012 and 2011 were \$0, \$172,000 and \$172,000, respectively.

F-18

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## Stockholder Rights Plan

In July 2007, the Company adopted a stockholder rights plan. The rights accompany each share of common stock of the Company and are evidenced by ownership of common stock. The rights are not exercisable except upon the occurrence of certain takeover-related events. Once triggered, the rights would entitle the stockholders, other than a person qualifying as an “Acquiring Person” pursuant to the rights plan, to purchase additional common stock at a 50% discount to their fair market value. The rights issued under the Rights Plan may be redeemed by the board of directors at a nominal redemption price of \$0.001 per right, and the board of directors may amend the rights in any respect until the rights are triggered.

## 9. Employee Benefit Plan

The Company has a defined contribution plan under Section 401(k) of the Internal Revenue Code covering all full-time employees, and providing for matching contributions by the Company, as defined in the plan. Participants in the plan may direct the investment of their personal accounts to a choice of mutual funds consisting of various portfolios of stocks, bonds or cash instruments. Contributions made by the Company to the plan for the years ended December 31, 2013, 2012 and 2011 were approximately \$378,000, \$349,000 and \$338,000, respectively.

## 10. Segment Information

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for making operating decisions and assessing performance. The Company’s financial reporting includes detailed data on four separate reportable segments. The Company’s has four operating segments: (1) Jewish Networks, which consists of JDate.com, JDate.co.uk, JDate.fr, JDate.co.il, Cupid.co.il, and their respective co-branded Web sites; (2) Christian Networks, which now consists of ChristianMingle.com, ChristianMingle.co.uk, ChristianMingle.com.au, Believe.com, ChristianCards.net, DailyBibleVerse.com and Faith.com; (3) Other Networks, which consists of Spark.com and related other general market Web sites as well as other properties which are primarily composed of sites targeted towards various religious, ethnic, geographic and special interest groups; and (4) Offline & Other Businesses, which consists of revenue generated from offline activities and HurryDate events and subscriptions.

(in thousands)	Years Ended December 31		
	2013	2012	2011
Revenue			
Jewish Networks	\$25,789	\$26,034	\$27,054
Christian Networks	40,245	31,574	15,742
Other Networks	2,972	3,765	4,925
Offline and Other Businesses	403	370	772
Total Revenue	\$69,409	\$61,743	\$48,493
Direct Marketing Expenses			
Jewish Networks	\$3,340	\$3,111	\$3,389
Christian Networks	48,016	41,400	19,356
Other Networks	595	977	2,467

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Offline and Other Businesses	123	165	512
Total Direct Marketing Expenses	\$52,074	\$45,653	\$25,724
Unallocated Operating Expense	29,449	25,270	23,913
Operating Loss	\$(12,114)	\$(9,180)	\$(1,144)

Due to the Company's integrated business structure, cost and expenses, other than direct marketing expenses, are not allocated to the individual reporting segments. As such, the Company does not measure operating profit or loss by segment for internal reporting purposes. Assets are not allocated to the different business segments for internal reporting purposes.

F-19

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The Company operates several international Web sites; however, many of them are operated and managed by the Company's U.S. operations. Foreign revenue represents sales generated outside the U.S. where the Company has its principal operations. Revenue and identifiable long-lived assets (excluding deferred tax assets, goodwill and intangibles) by geographical area are as follows:

	Years Ended December 31		
(in thousands)	2013	2012	2011
Revenue			
United States	\$65,354	\$57,734	\$44,358
Israel	4,055	4,009	4,135
Total Revenue	\$69,409	\$61,743	\$48,493

	As of December 31,	
	2013	2012
Long-Lived Assets		
United States	\$3,961	\$3,144
Israel	148	142
Total Long-Lived Assets	\$4,109	\$3,286

## 11. Commitments and Contingencies

### Operating Leases

The Company leases its office and data center facilities under operating lease agreements, providing for annual minimum lease payments as follows:

Year Ending (amounts in thousands)	
2014	\$1,029
2015	930
2016	777
2017	722
2018	514
Total	\$3,972

On February 1, 2013, the Company entered into an office lease for its Los Angeles location, which expires on October 31, 2018. The Company relocated to the new office space during the second quarter of 2013.

Rental expense under non-cancelable operating leases with scheduled rent increases or free rent is accounted for on a straight-line basis over the lease term. Leasehold improvement incentives are recorded as deferred credits and are amortized on a straight-line basis as a reduction of rent expense over the lease term.

The Company recognized rent expense under operating leases of \$0.8 million, \$1.0 million and \$1.0 million for the years ended December 31, 2013, 2012 and 2011, respectively.

#### Other Commitments and Obligations

The Company has other non-cancelable commitments and obligations consisting of contracts with software licensing, communications and marketing service providers. These amounts totaled \$355,000 for less than one year and \$338 between one and three years. Contracts with other service providers are for terms less than one year.

Year Ending (in thousands)	
2014	\$355
2015	338
2016	-
Total	\$693

Legal Proceedings

ISYSTEMS v. Spark Networks, Inc. et al.

On July 11, 2008, ISYSTEMS initiated a lawsuit against Spark Networks, Inc. and Spark Networks Limited (collectively, "Spark Networks") and other parties in the United States District Court, Northern District of Texas, Dallas Division. The lawsuit was filed in response to an arbitration award ordering the transfer of the domain name, JDATE.NET, to Spark Networks Limited from ISYSTEMS. Spark Networks was apprised of the lawsuit after ISYSTEMS unsuccessfully attempted to utilize the filing of the lawsuit to prevent the domain transfer to Spark Networks Limited. On December 1, 2008, Spark Networks filed a Motion to Dismiss the Complaint, or, Alternatively, for Summary Judgment. On September 10, 2009, the Court granted Spark Networks' motion and dismissed the case with prejudice. On September 22, 2009, ISYSTEMS filed a motion to vacate the order dismissing the action and requesting leave to amend its complaint. On October 26, 2009, the Court granted ISYSTEMS' motion and ISYSTEMS filed its Amended Complaint on November 25, 2009. On January 19, 2010, Spark Networks filed a Motion to Dismiss the Amended Complaint, or Alternatively, for Summary Judgment. The Court granted Spark Networks' Motion to Dismiss on June 28, 2010 and entered a judgment in favor of Spark Networks. On July 25, 2010, ISYSTEMS filed a motion to vacate the order granting the motion to dismiss, which was denied by the Court on August 11, 2010. On September 10, 2010, ISYSTEMS filed a notice of appeal of the district court's order and judgment to the United States Court of Appeals for the Fifth Circuit. On June 13, 2011, the United States Court of Appeals for the Fifth Circuit issued its opinion affirming the District Court's judgment. On June 29, 2011, ISYSTEMS filed a Petition for Rehearing with the United States Court of Appeals for the Fifth Circuit, which was granted. Oral argument was held on December 8, 2011. Per the Fifth Circuit's request, the parties submitted supplemental briefs on December 16, 2011. On March 21, 2012, the Fifth Circuit issued its opinion affirming the District Court's dismissal of certain claims and reversing the dismissal of certain other claims. On April 19, 2012, the matter was remanded back to the District Court. On September 4, 2012, Spark Networks filed its Answer to the Complaint. By written order dated August 30, 2012, the Court set the action for trial on February 24, 2014. On January 22, 2014, the Court entered an Amended Scheduling Order continuing the commencement of the trial to July 21, 2014.

Kirby, et al. v. Spark Networks USA, LLC

On October 16, 2012, Kristina Kirby, Christopher Wagner and Jamie Carper (collectively referred to as "Plaintiffs"), on behalf of themselves and all other similarly situated, filed a putative class action Complaint in the Superior Court for the State of California, County of Los Angeles alleging claims against Spark Networks USA, LLC for violations of California Business & Professions Code section 17529.5. Plaintiffs allege that certain e-mail communications advertising websites of Spark Networks USA, LLC and received by Plaintiffs violate a California statute prohibiting false and deceptive e-mail communications (namely, California Business & Professions Code section 17529.5). Plaintiffs generally allege that they seek damages in excess of \$25,000. As of March 28, 2013, the e-mail publishers responsible for distributing the e-mails at issue in this litigation have agreed to furnish a complete defense to the Company, through independent counsel at their own expense, pursuant to contractual indemnification provisions. The parties reached a settlement in principle to resolve the action on December 10, 2013, and are currently in the process of documenting the settlement for court approval.

Adconion v. Spark Networks USA, LLC

On December 18, 2013, Adconion Direct, Inc. (“Adconion”) filed a breach of contract lawsuit in the Superior Court of California of Los Angeles. Adconion alleges that it is a successor-in-interest to Frontline Direct Inc., with which Spark contracted for the placement of online advertisements. Adconion contends that it has performed all of its obligations pursuant to this contract, and that Spark failed to pay the January and February 2013 invoices, which total approximately \$438,000 and are included in accounts payable as of December 31, 2013. Spark filed an answer to the complaint on February 3, 2014 along with a cross complaint against Adconion for breach of contract, breach of the implied covenant of good faith and fair dealing, express contractual indemnity, fraudulent concealment and negligent interference with prospective economic advantage.

California Unruh Act Litigation

Werner, et al. v. Spark Networks, Inc. and Spark Networks USA, LLC and Wright, et al. v. Spark Networks, Inc., Spark Networks USA, LLC, et al.

On July 19, 2013, Aaron Werner, on behalf of himself and all other similarly situated individuals, filed a putative class action Complaint in the Superior Court for the State of California, County of Los Angeles alleging a single claim seeking an injunction and statutory, general and compensatory, treble and punitive damages as well as attorneys’ fees and costs and pre-judgment interest based on the allegation that Spark Networks’ ChristianMingle website violates California’s Unruh Civil Rights Act by allegedly discriminating based on sexual orientation. On December 23, 2013, Richard Wright, on behalf of himself and all other similarly situated individuals, filed a putative class action complaint (the “Complaint”) in the Superior Court for the State of California, County of San Francisco alleging a single claim against Spark Networks, Inc., seeking an injunction and statutory, general, compensatory and punitive damages as well as attorneys’ fees, costs and pre-judgment interest, based on the allegation that certain of the Company’s websites violate California’s Unruh Civil Rights Act by allegedly discriminating based on sexual orientation.

#### Israeli Consumer Actions

Ben-Jacob vs. Spark Networks (Israel) Ltd. and Gever vs. Spark Networks (Israel) Ltd. and Korland vs. Spark Networks (Israel) Ltd.

Three class action lawsuits have been filed in Israel alleging violations of the Israel Consumer Protection Law of 1981. Spark was served with a Statement of Claim and a Motion to Certify it as a Class Action in the Ben-Jacob action on January 14, 2014. The plaintiff alleges that Spark Networks (Israel) Ltd. refused to cancel her subscription and provide a refund for unused periods and claims that such a refusal is in violation of the Consumer Protection Law. Spark was served with a Statement of Claim and a motion to Certify it as a Class Action in the Gever action on January 21, 2014. The plaintiff alleges that Spark Networks (Israel) Ltd. renewed his one month subscription without receiving his positive agreement in advance and claims that such renewal is prohibited under the Consumer Protection Law. Spark was served with a Statement of Claim and a Motion to Certify it as a Class Action in the Korland action on February 12, 2014. The plaintiff alleges that Spark Networks (Israel) Ltd. refused to give her a full refund and charged her the price of a one month subscription to the JDate website in violation of the Consumer Protection Law. In each of these three cases, the plaintiff is seeking personal damages and damages on behalf of a defined group.

The Company strongly disputes the merits of the claims asserted against it in each of these lawsuits and shall vigorously defend against them.

The Company has additional existing legal claims and may encounter future legal claims in the normal course of business. In the Company's opinion, the resolutions of the existing legal claims are not expected to have a material impact on its financial position or results of operations. The Company believes it has accrued appropriate amounts, where necessary, in connection with the above litigation.

#### 12. Related Party Transactions

In January 2012, the Company entered into an agreement with Ultra Unlimited Corp., a software development firm, to develop and initially operate a Web site for the Company and to provide the Company with certain software. The Chief Executive Officer of Ultra Unlimited Corp. is the brother of Michael Kumin, a former director of the Company. Michael Kumin and Jonathan Bulkeley, also a director of the Company, have informed the Company that they are individual investors in Ultra Unlimited Corp. The Company paid Ultra Unlimited Corp. \$18,000 and \$159,000 for services rendered in 2013 and 2012, respectively.

In December 2011, the Company entered into a three year operating lease with Latisys-Irvine, Inc., a colocation and data center operator to provide colocation, cages, connectivity and other related equipment and services. Great Hill Partners, a former owner of more than 5% of the Company's stock, has informed the Company that it has an ownership position in Latisys-Irvine, Inc. The Company paid \$271,000 and \$189,000 for services rendered by Latisys-Irvine, Inc. in 2013 and 2012, respectively.

### 13. Quarterly Results of Operations

The following tables present the Company's quarterly results of operations and should be read in conjunction with the consolidated financial statements and related notes. The Company has prepared the unaudited information on substantially the same basis as our audited consolidated financial statements which, in the opinion of management, includes all adjustments, consisting only of normal recurring adjustments, except as otherwise indicated, necessary for the presentation of the results of operations for such periods. Operating results for any quarter are not necessarily indicative of results for any future quarters or for a full year.

F-22

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(in thousands, except per share amount)	Three Months Ended							
	Dec. 31, 2013	Sept.30, 2013	June 30, 2013	March 31, 2013	Dec.31, 2012	Sept.30, 2012	June 30, 2012	March 31, 2012
<b>Consolidated Statement of Operations Data:</b>								
Revenue	\$17,204	\$17,361	\$17,581	\$17,263	\$16,271	\$15,871	\$15,046	\$14,555
Cost of revenue	13,911	13,620	14,770	13,657	13,491	12,901	10,976	11,848
Sales and marketing	1,629	1,423	1,287	1,262	1,015	1,020	983	973
Customer service	765	746	688	703	647	652	622	613
Technical operations	280	288	267	332	296	362	355	350
Development	799	746	793	791	797	859	844	846
General and administrative	2,790	2,496	2,274	2,934	2,237	2,260	2,052	2,238
Depreciation	533	529	472	453	431	426	413	403
Amortization	10	10	—	—	—	—	—	13
Impairment of goodwill and other assets	—	—	265	—	—	—	—	—
Total cost and expenses	20,717	19,858	20,816	20,132	18,914	18,480	16,245	17,284
Loss from operations	(3,513 )	(2,497 )	(3,235 )	(2,869 )	(2,643 )	(2,609 )	(1,199 )	(2,729 )
Interest expense (income) and other, net	(56 )	(77 )	(43 )	(53 )	(188 )	(36 )	113	(127 )
Loss before income taxes	(3,457 )	(2,420 )	(3,192 )	(2,816 )	(2,455 )	(2,573 )	(1,312 )	(2,602 )
Provision (benefit)for income taxes	92	195	84	124	8,083	(836 )	(311 )	(889 )
Net loss	\$(3,549 )	\$(2,615 )	\$(3,276 )	\$(2,940 )	\$(10,538 )	\$(1,737 )	\$(1,001 )	\$(1,713 )
Net loss per share—Basic and diluted	\$(0.15 )	\$(0.11 )	\$(0.15 )	\$(0.14 )	\$(0.51 )	\$(0.08 )	\$(0.05 )	\$(0.08 )
Shares used in computation of basic and diluted net loss per share	23,938	23,753	22,485	20,960	20,816	20,699	20,625	20,596

#### 14. Subsequent Events (unaudited)

The Company evaluated subsequent events through the date this Annual Report on Form 10-K was filed with the Securities and Exchange Commission.

In December 2013, the Company's Board of Directors authorized the repurchase of up to \$5.0 million of common stock. From January 1, 2014 up until March 13, 2014, the Company repurchased an aggregate of 271,117 shares of common stock at average process between shares of common stock at average prices between \$4.57 and \$6.00. Based on these repurchases, the Company may repurchase a remaining amount of up to \$3.5 million of common stock. Repurchases may be made from time to time in the open market, in privately negotiated transactions, or otherwise, including pursuant to a Rule 10b5-1 plan, at prices that the Company deems appropriate and subject to market conditions, applicable law, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended, and other factors deemed relevant in the Company's sole discretion.

F-23