

SPARK NETWORKS INC  
Form 10-Q  
November 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

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

Commission file number: 001-32750

SPARK NETWORKS, INC.

(Exact name of registrant as specified in its charter)

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

11150 Santa Monica Boulevard, Suite 600

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

(310) 893-0550

(Registrant's telephone number, including area code)

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(Former name, former address and former fiscal year, if changed since last report)

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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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 Exchange Act). Yes  No

The registrant had 24,332,106 shares of common stock, par value \$0.001 per share, outstanding as of November 6, 2014.

SPARK NETWORKS, INC.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

## SPARK NETWORKS, INC.

## CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands, except share data)

|   | September<br>30,<br>2014 | December 31,<br>2013 |
|---|--------------------------|----------------------|
| Assets  |                          |                      |
| Current assets:   |                          |                      |
| Cash and cash equivalents   | \$ 9,309                 | \$ 14,723            |
| Restricted cash   | 1,124                    | 1,296                |
| Accounts receivable   | 1,457                    | 1,569                |
| Deferred tax asset – current  | 10                       | 10                   |
| Prepaid expenses and other  | 935                      | 1,787                |
| Total current assets  | 12,835                   | 19,385               |
| Property and equipment, net   | 3,918                    | 3,901                |
| Goodwill  | 8,893                    | 9,305                |
| Intangible assets, net  | 2,481                    | 2,269                |
| Deferred tax asset – non-current  | —                        | 186                  |
| Deposits and other assets   | 244                      | 208                  |
| Total assets  | \$ 28,371                | \$ 35,254            |
| Liabilities and Stockholders' Equity  |                          |                      |
| Current liabilities:  |                          |                      |
| Accounts payable  | \$ 777                   | \$ 1,516             |
| Accrued liabilities   | 4,809                    | 5,761                |
| Deferred revenue  | 7,909                    | 8,830                |
| Deferred tax liability – current  | 526                      | 526                  |
| Total current liabilities   | 14,021                   | 16,633               |
| Deferred tax liability – non-current  | 1,723                    | 1,781                |
| Other liabilities   | 1,662                    | 1,717                |
| Total liabilities   | 17,406                   | 20,131               |
| Commitments and contingencies (Note 10)   |                          |                      |
| 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 | —                        | —                    |
|   | 26                       | 24                   |

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100,000,000 shares of Common Stock, \$0.001 par value, with 24,274,022 and 24,001,937 shares of Common Stock issued and outstanding at September 30, 2014 and December 31, 2013, respectively:

|  |           |           |
|--|-----------|-----------|
| Additional paid-in-capital                 | 71,599    | 70,747    |
| Accumulated other comprehensive income     | 760       | 776       |
| Accumulated deficit                        | (61,420 ) | (56,424)  |
| Total stockholders' equity                 | 10,965    | 15,123    |
| Total liabilities and stockholders' equity | \$ 28,371 | \$ 35,254 |

See accompanying notes

## SPARK NETWORKS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(unaudited, in thousands, except per share data)

|  | Three Months<br>Ended<br>September 30, |            | Nine Months<br>Ended<br>September 30, |            |
|--|--|------------|---------------------------------------|------------|
|  | 2014                                   | 2013       | 2014                                  | 2013       |
| Revenue  | \$15,008                               | \$17,361   | \$47,381                              | \$52,205   |
| Cost and expenses:   |  |            |                                       |            |
| Cost of revenue (exclusive of depreciation shown separately below) | 7,004                                  | 13,620     | 28,234                                | 42,046     |
| Sales and marketing  | 1,368                                  | 1,423      | 4,299                                 | 3,972      |
| Customer service   | 738                                    | 746        | 2,289                                 | 2,136      |
| Technical operations   | 276                                    | 288        | 917                                   | 887        |
| Development  | 886                                    | 746        | 2,645                                 | 2,331      |
| General and administrative   | 4,446                                  | 2,496      | 11,472                                | 7,704      |
| Depreciation   | 518                                    | 529        | 1,558                                 | 1,454      |
| Amortization of intangible assets other than goodwill              | 10                                     | 10         | 30                                    | 10         |
| Impairment of long-lived assets                                    | 103                                    | —          | 103                                   | 265        |
| Total cost and expenses  | 15,349                                 | 19,858     | 51,547                                | 60,805     |
| Operating loss   | (341 )                                 | (2,497 )   | (4,166 )                              | (8,600 )   |
| Interest expense (income) and other, net                           | 340                                    | (77 )      | 323                                   | (172 )     |
| Loss before income taxes   | (681 )                                 | (2,420 )   | (4,489 )                              | (8,428 )   |
| Provision for income taxes   | 288                                    | 195        | 507                                   | 403        |
| Net loss   | \$(969 )                               | \$(2,615 ) | \$(4,996 )                            | \$(8,831 ) |
| Other comprehensive loss, net of tax:                              |  |            |                                       |            |
| Foreign currency translation adjustments                           | \$(27 )                                | \$23       | \$(16 )                               | \$45       |
| Comprehensive loss   | (996 )                                 | \$(2,592 ) | \$(5,012 )                            | \$(8,786 ) |
| Net loss per share—basic and diluted                               | \$(0.04 )                              | \$(0.11 )  | \$(0.21 )                             | \$(0.39 )  |
| Weighted average shares outstanding – basic and diluted            | 24,035                                 | 23,753     | 23,936                                | 22,410     |

|                            | Stock-based compensation: Three Months Ended |      |    | Stock-based compensation: Nine Months Ended |      |     |
|----------------------------|--|------|----|---|------|-----|
|                            | September 30,                                |      |    | September 30,                               |      |     |
|                            | 2014   | 2013 |    | 2014  | 2013 |     |
| Cost of revenue            | \$ 3   |      | \$ | — \$ 3                                      | \$ — |     |
| Sales and marketing        |  | 23   | 36 |   | 99   | 107 |
| Technical operations       | —  | 2    |    | —   | 4    |     |
| Development                | —  | 3    |    | —   | 10   |     |
| General and administrative | 259  | 153  |    | 511   | 455  |     |

See accompanying notes

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## SPARK NETWORKS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

|   | Nine Months<br>Ended<br>September 30, |            |
|---|---------------------------------------|------------|
|   | 2014                                  | 2013       |
| Cash flows from operating activities:                                   |                                       |            |
| Net loss  | \$ (4,996 )                           | \$(8,831 ) |
| Adjustments to reconcile net loss to cash used in operating activities: |                                       |            |
| Depreciation and amortization   | 1,588                                 | 1,464      |
| Impairment of long-lived assets   | 103                                   | 265        |
| Foreign exchange gain on intercompany loan                              | (284)                                 | (215 )     |
| Stock-based compensation  | 613                                   | 576        |
| Deferred taxes  | 137                                   | 364        |
| Other   | -                                     | 66         |
| Changes in operating assets and liabilities:                            |                                       |            |
| Accounts receivable, net  | 112                                   | 16         |
| Restricted cash   | 172                                   | (88 )      |
| Prepaid expenses and other assets                                       | 1,487                                 | (421 )     |
| Accounts payable and accrued liabilities                                | (1,739 )                              | (6 )       |
| Deferred revenue  | (921 )                                | 1,143      |
| Other liabilities   | (51)                                  | 175        |
| Net cash used in operating activities                                   | (3,779 )                              | (5,492 )   |
| Cash flows from investing activities:                                   |                                       |            |
| Purchases of property and equipment                                     | (1,631 )                              | (2,150 )   |
| Purchases of intangible assets  | (242 )                                | (355 )     |
| Net cash used in investing activities                                   | (1,873 )                              | (2,505 )   |
| Cash flows from financing activities:                                   |                                       |            |
| Proceeds from issuance of stock from exercise of stock options          | 1,730                                 | 2,529      |
| Net proceeds from issuance of common stock                              | -                                     | 12,253     |
| Repurchases of common stock   | (1,492 )                              | -          |
| Net cash provided by financing activities                               | 238                                   | 14,782     |
| Net (decrease) increase in cash and cash equivalents                    | (5,414 )                              | 6,785      |
| Cash and cash equivalents at beginning of period                        | 14,723                                | 10,458     |
| Cash and cash equivalents at end of period                              | \$9,309                               | \$17,243   |
| Supplemental disclosure of cash flow information:                       |                                       |            |
| Cash paid for income taxes  | \$ 36                                 | 59         |



See accompanying notes

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. The Company and Summary of Significant Accounting Policies

The Company

Spark Networks, Inc., a Delaware corporation (the “Company”), is a leading global media business, focused on creating iconic niche-focused brands that build and strengthen the communities they serve. Core properties are primarily online dating websites accessible via desktop and mobile devices that enable adults to meet, participate in a community and form relationships with like-minded individuals by utilizing many features on its websites, such as detailed profiles, onsite email centers, real-time chat rooms, instant messaging services, suggested matches, interactive games and advanced searching tools. Currently, the Company’s largest and most recognizable websites are ChristianMingle.com and JDate.com. The Company also operates several international websites and maintains physical operations in both the United States and Israel.

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 and six 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.

Basis of Presentation

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 accompanying unaudited consolidated interim financial statements reflect all adjustments, consisting of only normal recurring items, which, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future periods.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States (“GAAP”) requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, cost of revenue, prepaid advertising, website and software development costs, goodwill, intangible and other long-lived assets, accounting for business combinations, legal contingencies, income taxes and stock-based compensation. In addition, the Company uses assumptions when employing the Black-Scholes option valuation model to calculate the fair value of granted stock-based awards. The Company bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results may differ from these estimates.

The consolidated financial statements on this Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2013 was derived from the Company's audited consolidated financial statements for the year ended December 31, 2013.

## 2. Adoption of New Accounting Principles

In July 2013, the Financial Accounting Standards Board ("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. 2013-11 on January 1, 2014. The effect of this adoption did not have a material impact on the Company's consolidated financial position or results of operations.

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In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360)—Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which includes amendments that change the requirements for reporting discontinued operations and require additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations that have, or will have, a major effect on the organization’s operations and financial results should be presented as discontinued operations. Additionally, ASU No. 2014-08 requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The amendments in ASU No. 2014-08 will be applied prospectively to annual periods beginning on or after December 15, 2014, and interim periods within those years, with early adoption permitted. The Company adopted ASU No. 2014-08 in the third quarter of 2014, which did not have a material impact on the Company’s interim consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 provides for a single, principles-based model for revenue recognition that replaces the existing revenue recognition guidance. ASU No. 2014-09 is effective for annual and interim periods beginning on or after December 15, 2016 and will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective. It permits the use of either a retrospective or cumulative effect transition method and early adoption is not permitted. The Company is currently assessing the impact the guidance will have upon adoption.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40) – Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern, which requires entities to evaluate their ability to continue as a going concern within one year after the date that the financial statements are issued. Disclosure is required if there is substantial doubt about an entity’s ability to continue as a going concern. The guidance in ASU No. 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter, with early application permitted. The Company does not expect that the adoption of this ASU will have a material impact on the consolidated financial statements.

### 3. Net Loss Per Share

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 Three<br>Months<br>September 30,<br>2014 |            | For the Nine<br>Months<br>September 30,<br>2013 |            |
|---|--|------------|---|------------|
| (in thousands, except per share data)                   |  |            |   |            |
| Net Loss Per Share of Common Stock – Basic and Diluted  |  |            |   |            |
| Net loss applicable to common stock                     | \$(969 )   | \$(2,615 ) | \$(4,996 )                                      | \$(8,831 ) |
| Weighted average shares outstanding – basic and diluted | 24,035   | 23,753     | 23,936  | 22,410     |
| Net Loss Per Share – Basic and Diluted                  | \$(0.04 )  | \$(0.11 )  | \$(0.21 )                                       | \$(0.39 )  |

For the three and nine months ended September 30, 2014 and 2013, all stock options outstanding during each period have been excluded from the diluted weighted average shares outstanding calculation because they would have been anti-dilutive.

#### 4. 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 in compliance with the Credit Agreement's customary affirmative and negative covenants, as of September 30, 2014. However, subsequent to September 30, 2014, management determined it may not achieve compliance with the minimum quarterly revenue covenant for the fourth quarter ending December 31, 2014. The Company will be discussing an amendment to the Credit Agreement with Bank of America.

On July 2, 2014, there was a change in the majority of the members of the Company's Board of Directors. Under the terms of the Credit Agreement, a change in the majority of the Company's Board, constitutes a change in control, which is one of the enumerated events of default under the Credit Agreement. On July 15, 2014, the parties executed a Consent Agreement, pursuant to which the lenders consented to the changes in the Board.

As of September 30, 2014, there were no outstanding borrowings under the Credit Agreement. The deferred financing costs are amortized to interest expense (income) and other, net 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 three and nine months ended September 30, 2014 was \$3,000 and \$9,000, respectively. Amortization expense for the deferred financing costs for the three and nine months ended September 30, 2013 was \$9,000 and \$26,000, respectively. The unamortized balance of deferred financing costs was \$16,000 as of September 30, 2014.

#### 5. Impairment of Long-lived Assets

During the three and nine months ended September 30, 2014, the Company impaired \$103,000 of long-lived assets primarily related to the full unamortized balance of capitalized software development costs associated with certain mobile products. In the second quarter of 2013, the Company impaired \$265,000 of long-lived assets, representing the full unamortized balance of capitalized software development costs related to certain web-based products that failed to perform to Company standards.

#### 6. 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. During the three and nine months ended September 30, 2014, the Company repurchased 0 shares of common stock, and 271,117 shares of common stock at a weighted average price of \$5.50, respectively. All stock repurchased has been retired.

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.

7. Stock-Based Compensation  
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.

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.

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As of September 30, 2014, total unrecognized compensation cost related to non-vested stock options was \$0.7 million. This cost is expected to be recognized over a weighted-average period of 3 years.

The following table describes option activity for the three and nine months ended September 30, 2014:

|                                   | Number of<br>Shares<br>(in<br>thousands) | Weighted<br>Average<br>Price per<br>Share |
|-----------------------------------|--|---|
| Outstanding at December 31, 2013  | 2,952                                    | \$ 4.19                                   |
| Granted                           | 100                                      | 4.87                                      |
| Exercised                         | (70 )                                    | 3.06                                      |
| Forfeited                         | (29 )                                    | 6.21                                      |
| Expired                           | —  | —   |
| Outstanding at March 31, 2014     | 2,953                                    | \$ 4.24                                   |
| Granted                           | 40                                       | 4.51                                      |
| Exercised                         | (115 )                                   | 2.80                                      |
| Forfeited                         | (40 )                                    | 4.51                                      |
| Expired                           | —  | —   |
| Outstanding at June 30, 2014      | 2,838                                    | \$ 4.29                                   |
| Granted                           | 300                                      | 5.32                                      |
| Exercised                         | (375 )                                   | 3.31                                      |
| Forfeited                         | (308 )                                   | 6.03                                      |
| Expired                           | —  | —   |
| Outstanding at September 30, 2014 | 2,455                                    | \$ 4.35                                   |

#### 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.

#### 8. Accumulated Other Comprehensive Income

The following table summarizes the changes in accumulated balances of other comprehensive income for the nine months ended September 30, 2014.

Foreign  
Currency  
Translation



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|  |  |
|--|--|
|  | (all<br>balances<br>are in<br>thousands,<br>net of \$0<br>tax) |
| Balance at December 31, 2013                                     | \$ 776   |
| Other comprehensive income before reclassifications              | (1 )   |
| Amounts reclassified from accumulated other comprehensive income | —  |
| Balance at March 31, 2014  | \$ 775   |
| Other comprehensive income before reclassifications              | 12   |
| Amounts reclassified from accumulated other comprehensive income | —  |
| Balance at June 30, 2014   | \$ 787   |
| Other comprehensive income before reclassifications              | (27 )  |
| Amounts reclassified from accumulated other comprehensive income | —  |
| Balance at September 30, 2014                                    | \$ 760   |

There were no reclassifications out of accumulated other comprehensive income for the nine months ended September 30, 2014.

## 9. Segment Information

Segment reporting requires the use of the management approach in determining 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: (1) Jewish Networks, which consists of JDate.com, JDate.co.uk, JDate.fr, JDate.co.il, Cupid.co.il and their respective co-branded websites; (2) Christian Networks, which 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 websites, 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)                  | Three Months Ended |                    | Nine Months Ended  |                    |
|---------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                 | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Revenue                         |                    |                    |                    |                    |
| Jewish Networks                 | \$5,724            | \$6,433            | \$17,743           | \$19,345           |
| Christian Networks              | 8,672              | 10,088             | 27,660             | 30,256             |
| Other Networks                  | 533                | 715                | 1,713              | 2,305              |
| Offline & Other Businesses      | 79                 | 125                | 265                | 299                |
| Total revenue                   | 15,008             | 17,361             | 47,381             | 52,205             |
| Direct marketing expenses       |                    |                    |                    |                    |
| Jewish Networks                 | 628                | 822                | 2,436              | 2,349              |
| Christian Networks              | 5,293              | 11,659             | 22,470             | 36,247             |
| Other Networks                  | 107                | 123                | 364                | 474                |
| Offline & Other Businesses      | 19                 | 30                 | 72                 | 87                 |
| Total direct marketing expenses | 6,047              | 12,634             | 25,342             | 39,157             |
| Unallocated operating expenses  | 9,302              | 7,224              | 26,205             | 21,648             |
| Operating loss                  | \$(341 )           | \$(2,497 )         | \$(4,166 )         | \$(8,600 )         |

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.

## 10. Commitments and Contingencies

## 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. By written order dated August 30, 2012, the Court set the action for trial on February 24, 2014. On September 4, 2012, Spark Networks filed its Answer to the Complaint. On January 22, 2014, the court entered an Amended Scheduling Order continuing the commencement of the trial to July 21, 2014. The matter was tried before the Honorable David C. Godbey from July 21-22, 2014. On September 19, 2014, the Court issued a Final Judgment in favor of Spark Networks and ruling that ISYSTEMS takes nothing by its claims which were dismissed with prejudice. On October 17, 2014, ISYSTEMS filed a Motion for a New Trial. No ruling on ISYSTEMS' Motion for a New Trial has been issued to date.

#### 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 others 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 ("Spark Networks") for violations of California Business & Professions Code section 17529.5. Plaintiffs allege that certain e-mail communications advertising websites of Spark Networks 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. The e-mail publishers responsible for distributing the e-mails at issue in this litigation agreed to furnish a complete defense to the Spark Networks, through independent counsel at their own expense, pursuant to contractual indemnification provisions. The parties reached a settlement to resolve the action on a classwide basis. They have executed a settlement agreement and filed the necessary approval paperwork with the court. The court granted plaintiffs' motion for preliminary approval of the settlement on October 14, 2014. Notice to putative class members began on October 24, 2014, and the court has scheduled a hearing for final approval of the settlement on February 3, 2015.

At this time, the Company does not anticipate that its liability will exceed \$75,000 if this settlement agreement is approved by the court.

#### 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.

The parties agreed to a confidential settlement to resolve their dispute for an amount less than the past due invoices, and the case (including all claims and cross-claims) was dismissed in its entirety on May 23, 2014.

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 (the “Werner Complaint”) in the Superior Court for the State of California, County of Los Angeles against Spark Networks, Inc. and Spark Networks USA, LLC (collectively “Spark Networks”). The Werner Complaint alleges that Spark Networks’ website ChristianMingle.com violates California’s Unruh Civil Rights Act (the “Unruh Act”) by allegedly discriminating on the basis of sexual orientation. The Werner Complaint requests the following relief: an injunction, statutory, general, compensatory, treble and punitive damages, attorneys’ fees and costs, pre-judgment interest, and an award for any other relief the Court deems just and appropriate. On December 23, 2013, Richard Wright, on behalf of himself and all other similarly situated individuals, filed a putative Class Action Complaint (the “Wright Complaint”) in the Superior Court for the State of California, County of San Francisco against Spark Networks, Inc. The Wright Complaint alleges that Spark Networks’ commercial dating services including ChristianMingle.com, LDSSingles.com, CatholicMingle.com, BlackSingles.com, MilitarySinglesConnection.com and AdventistSinglesConnection.com violate the Unruh Act by allegedly intentionally and arbitrarily discriminating on the basis of sexual orientation. The Wright Complaint requests the following relief: a declaratory judgment, a preliminary and permanent injunction, statutory penalties, reasonable attorneys’ fees and costs, pre-judgment interest, and an award for any other relief the Court deems just and appropriate. These matters are temporarily stayed while the parties explore whether an agreed upon resolution is possible.

Israeli Consumer Actions

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

Three class action law suits 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. (“Spark Networks”) 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 Networks 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 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 Networks 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 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. On May 8, 2014, the Court granted Spark Networks’ motion to consolidate all three cases. All three cases are now consolidated and will be litigated jointly. Spark Networks’ combined response to their motions to certify the classes was filed November 1, 2014.

Please refer to the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 for a description of additional litigation and claims.

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.

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 December 31 (amounts in thousands) |         |
|--|---------|
| 2014   | \$281   |
| 2015   | 788     |
| 2016   | 777     |
| 2017   | 722     |
| 2018 and thereafter                            | 514     |
| Total  | \$3,082 |

#### 11. Income Taxes

The Company did not recognize tax benefit for losses incurred in the nine months ended September 30, 2014, as the Company recorded a valuation allowance against deferred tax assets. The Company recorded a provision for income tax of \$507,000 for the nine months ended September 30, 2014 which consists of \$269,000 of deferred tax related to an increase in the deferred tax liability associated with tax deductible amortization of goodwill and other indefinite lived intangibles, \$174,000 of foreign and state current taxes and \$64,000 related to interest accrued on its uncertain tax positions.

#### 12. Related Party Transactions

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, informed the Company that it had an ownership position in Latisys-Irvine, Inc. The Company paid \$271,000 for services rendered by Latisys-Irvine, Inc. for the full year in 2013. Great Hill Partners is no longer a shareholder of the Company and the Latisys-Irvine business arrangement is no longer considered a related party transaction for 2014.

During the three months ended September 30, 2014, the Company reimbursed Osmium Partners, LLC and 402 Capital, LLC and paid certain of its vendors for costs incurred in connection with a proxy contest to take control over the Company's Board of Directors. For the nine months ended September 30, 2014, the Company paid for approximately \$509,000 of the costs incurred by Osmium Partners, LLC and 402 Capital, LLC.

## ITEM 2. 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 unaudited consolidated financial statements and the related notes that are included in this Quarterly Report and the audited consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Annual Report").

Some of the statements contained in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Quarterly 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" 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 including, but not limited to our ability to: attract members; convert members into paying subscribers and retain our paying subscribers; develop or acquire new product offerings and successfully implement and expand those offerings; keep pace with rapid technological changes; maintain the strength of our existing brands and maintain and enhance those brands; and continue to depend upon the telecommunications infrastructure and our networking hardware and software infrastructure; identify and consummate strategic acquisitions and integrate acquired companies or assets; obtain financing on acceptable terms; and successfully implement both cost cutting initiatives and our current long-term growth strategy, and other factors described in the "Risk Factors" section of this Form 10Q and our 2013 Annual Report.

### General

The common stock of Spark Networks, Inc. (the "Company") is traded on the NYSE MKT. 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 dating websites accessible via desktop and mobile devices 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 websites, such as detailed profiles, onsite email centers, real-time chat rooms, instant messaging services, suggested matches, interactive games and advanced searching tools.

### Critical Accounting Policies

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 of America. 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, website 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.

There were no significant changes to our critical accounting policies during the nine months ended September 30, 2014, as compared to those policies disclosed in our Annual Report on Form 10-K for the fiscal year ended



December 31, 2013.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360)—Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which includes amendments that change the requirements for reporting discontinued operations and require additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations that have, or will have, a major effect on the organization's operations and financial results should be presented as discontinued operations. Additionally, ASU No. 2014-08 requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The amendments in ASU No. 2014-08 will be applied prospectively to annual periods beginning on or after December 15, 2014, and interim periods within those years, with early adoption permitted. The Company adopted ASU No. 2014-08 in the third quarter of 2014, which did not have a material impact on the Company's interim consolidated financial statements.

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In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 provides for a single, principles-based model for revenue recognition that replaces the existing revenue recognition guidance. ASU No. 2014-09 is effective for annual and interim periods beginning on or after December 15, 2016 and will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective. It permits the use of either a retrospective or cumulative effect transition method and early adoption is not permitted. The Company is currently assessing the impact the guidance will have upon adoption.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40) – Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern, which requires entities to evaluate their ability to continue as a going concern within one year after the date that the financial statements are issued. Disclosure is required if there is substantial doubt about an entity’s ability to continue as a going concern. The guidance in ASU No. 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter, with early application permitted. The Company does not expect that the adoption of this ASU will have a material impact on the consolidated financial statements.

### 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 website 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.

|                                  | Three Months Ended |         | Nine Months Ended |         |
|----------------------------------|--------------------|---------|-------------------|---------|
|                                  | September 30,      |         | September 30,     |         |
| Average Paying Subscribers       | 2014               | 2013    | 2014              | 2013    |
| Jewish Networks                  | 76,481             | 83,732  | 78,577            | 84,473  |
| Christian Networks               | 166,908            | 197,420 | 179,074           | 193,638 |
| Other Networks                   | 14,290             | 19,073  | 15,371            | 21,230  |
| Total Average Paying Subscribers | 257,679            | 300,225 | 273,022           | 299,341 |

Average paying subscribers for the Jewish Networks segment decreased 8.7% to 76,481 in the three months ended September 30, 2014 compared to 83,732 in the same period last year and decreased 7.0% to 78,577 in the nine months ended September 30, 2014 compared to 84,873 in the same period last year. The decrease can be primarily attributed to certain affiliate-driven email deliverability issues we experienced in the first quarter of 2014, an increase in failed renewal transactions as a result of credit and debit card turnover associated with a security breach at a major US-based retailer and increased competition in our international operations. During the first quarter of 2014, some of our email affiliates conducted their business in violation of our terms and conditions and in a manner considered unacceptable by certain email internet service providers. As a result, for a significant portion of the first quarter of 2014, certain internet service providers either prevented emails sent by us from reaching our members or placed our emails into our members’ email spam boxes. The reduction of email communication from our Company to our members negatively affected our ability to convert non-paying members into paying subscribers. Although we resolved this issue in early March 2014, we entered the third quarter with an average paying subscriber base that was 6.7% lower than the third quarter of 2013, which impacted revenue during the third quarter. Average paying subscribers for the Christian Networks segment decreased 15.5% to 166,908 and 7.5% to 179,074 in the three and nine months ended September

30, 2014 compared to 197,420 and 193,638 in the same periods last year. The decrease in the average paying subscriber base reflects the reduction and reallocation of our direct marketing investments in this segment, and the email deliverability and payment card renewal issues noted above with respect to the Jewish Networks segment. Average paying subscribers for the Other Networks segment decreased 25.1% to 14,290 and 27.6% to 15,371 in the three and nine months ended September 30, 2014 compared to 19,073 and 21,230 in the same period last year. The decrease in the average paying subscribers in this segment reflects the elimination of certain inefficient marketing investments made in prior periods.

## Results of Operations

The following table presents our operating results as a percentage of revenue:

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2014                                | 2013     | 2014                               | 2013     |
| Revenue                                  | 100.0 %                             | 100.0 %  | 100.0 %                            | 100.0 %  |
| Cost and expenses:                       |                                     |          |                                    |          |
| Cost of revenue                          | 46.7                                | 78.5     | 59.6                               | 80.5     |
| Sales and marketing                      | 9.1                                 | 8.2      | 9.1                                | 7.6      |
| Customer service                         | 4.9                                 | 4.3      | 4.8                                | 4.1      |
| Technical operations                     | 1.8                                 | 1.7      | 1.9                                | 1.7      |
| Development                              | 5.9                                 | 4.3      | 5.6                                | 4.5      |
| General and administrative               | 29.6                                | 14.3     | 24.2                               | 14.8     |
| Depreciation                             | 3.5                                 | 3.0      | 3.3                                | 2.8      |
| Amortization of intangible assets        | 0.1                                 | 0.1      | 0.1                                | —        |
| Impairment of goodwill and other assets  | 0.7                                 | —        | 0.2                                | 0.5      |
| Total cost and expenses                  | 102.3                               | 114.4    | 108.8                              | 116.5    |
| Operating loss                           | (2.3 )                              | (14.4 )  | (8.8 )                             | (16.5 )  |
| Interest expense (income) and other, net | 2.3                                 | (0.4)    | 0.7                                | (0.4)    |
| Loss before income taxes                 | (4.6 )                              | (14.0 )  | (9.5 )                             | (16.1 )  |
| Provision for income taxes               | 1.9                                 | 1.1      | 1.1                                | 0.8      |
| Net loss                                 | (6.5 )%                             | (15.1 )% | (10.6 )%                           | (16.9 )% |

Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013

## Revenue

The vast majority of our revenue is derived from subscription fees. Approximately 5.6% and 4.6% of our revenue in the three months ended September 2014 and 2013, respectively, was generated through offline social 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 and six 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 for a term equal to their initial plan lengths.

Revenue decreased 13.6% to \$15.0 million in the three months ended September 30, 2014 as compared to \$17.4 million in the same period of 2013. The decrease was primarily attributable to declines in subscription revenue in our Christian and Jewish Networks segments.

Revenue for Christian Networks decreased 14.0% to \$8.7 million in the three months ended September 30, 2014 as compared to \$10.1 million in the same period in 2013. This decline was primarily attributable to a 15.5% decrease in our average paying subscriber base. The lower average paying subscriber base is a result of the affiliate-driven email deliverability challenges in combination with the reduction and reallocation of our direct marketing investments, the latter of which resulted in lower direct marketing spend during the quarter.

Revenue for Jewish Networks decreased 11.0% to \$5.7 million in the three months ended September 30, 2014 as compared to \$6.4 million in the same period in 2013. The decline was primarily attributable to an 8.7% decrease in average paying subscribers due to the factors noted above.

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Revenue for our Other Networks segment decreased 25.5% to \$533,000 in the three months ended September 30, 2014 as compared to \$715,000 in the same period in 2013. The decrease in revenue was primarily due to a 25.1% decrease in average paying subscribers, reflecting the elimination of select inefficient online marketing investments.

Revenue for the Offline & Other Businesses segment decreased 36.8% to \$79,000 in the three months ended September 30, 2014 as compared to \$125,000 in the same period in 2013.

## Cost and Expenses

Cost and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Cost and expenses in the three months ended September 30, 2014 decreased 22.7% to \$15.3 million, as compared to \$19.9 million in the same period in 2013. The decrease was primarily attributable to a \$6.6 million decrease in cost of revenue, partially offset by a \$2.0 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 for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue decreased 48.6% to \$7.0 million in the three months ended September 30, 2014 as compared to \$13.6 million in the same period in 2013. This decrease can be primarily attributed to lower Christian Networks direct marketing expenses. Direct marketing expenses for the Christian Networks segment decreased 54.6% to \$5.3 million in the three months ended September 30, 2014 as compared to \$11.7 million in the same period in 2013. The lower direct marketing expense primarily reflects lower online and offline advertising spend as we reduce and reallocate our marketing investments to more efficient channels, partners and programming.

**Sales and marketing.** Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses were flat at \$1.4 million in the three months ended September 30, 2014 and September 30, 2013.

**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 were basically flat at \$738,000 in the three months ended September 30, 2014 as compared to \$746,000 in the same period in 2013.

**Technical operations.** Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses decreased 4.2% to \$276,000 in the three months ended September 30, 2014 as compared to \$288,000 in the same period in 2013. The decrease is primarily due to lower salaries expense, reflecting a shift in staffing.

**Development.** Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our websites and services. Development expenses increased 18.8% to \$886,000 in the three months ended September 30, 2014 as compared to \$746,000 in the same period in 2013. The increased costs reflect higher compensation expense associated with the expansion of our mobile development team and lower capitalized software development costs.

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 78.1% to \$4.4 million in the three months ended September 30, 2014 as compared to \$2.5 million in the same period in 2013. The increase can be primarily attributed to \$1.2 million of cash compensation associated with the separation of our former chief executive officer and general counsel, and the reimbursement of certain dissident shareholder proxy contest fees and expenses totaling approximately \$509,000.

Depreciation. Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expenses decreased 2.1% to \$518,000 in the three months ended September 30, 2014 as compared to \$529,000 in the same period of 2013. The decrease was primarily attributable to lower capitalized software costs.

Amortization of intangible assets. Amortization expenses consist primarily of amortization of intangible assets related to previous acquisitions. The Company recorded \$10,000 for amortization expenses in the three months ended September 30, 2014, as compared to \$10,000 in the same period of 2013.

Impairment of long-lived assets. Impairment of long-lived assets consist primarily represents the write-down of investments in businesses and computer software. The Company recorded a \$103,000 impairment expense in the three months ended September 30, 2014, as compared to nil in the same period of 2013. The impairment expense reflects the write-off of the fully unamortized balance of capitalized software development costs associated with certain mobile products.

Interest expense (income) and other, net. Interest expense (income) and other, net consists 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 the borrowings from our revolving credit facility. Interest expense (income) and other, net was \$340,000 of expense in the three months ended September 30, 2014 as compared to \$77,000 of income in the same period in 2013. The shift from income to expense primarily reflects a non-cash charge associated with currency fluctuations associated with an intercompany loan.

Provision for income taxes. We did not recognize a tax benefit for losses incurred in the three months ended September 30, 2014, as we recorded a valuation allowance against our deferred tax assets. We recorded a provision for income taxes of \$288,000 in the three months ended September 30, 2014 which consists of \$165,000 of deferred tax related to an increase in the deferred tax liability associated with tax deductible amortization of goodwill and other indefinite lived intangibles, \$101,000 of foreign and state current tax and \$22,000 related to interest accrued on uncertain tax positions.

Net loss. Net loss was \$969,000 and \$2.6 million in the three months ended September 30, 2014 and 2013, respectively. A \$4.2 million increase in contribution, offset by a \$2.0 million increase in general and administrative expenses in the third quarter of 2014 accounted for the smaller net loss.

#### Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

##### Revenue

The vast majority of our revenue is derived from subscription fees. Approximately 5.5% and 4.3% of our revenue in the nine months ended September 30, 2014 and 2013, respectively, was generated through offline social 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 and six 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 decreased 9.2% to \$47.4 million in the first nine months of 2014 as compared to \$52.2 million in the same period of 2013. The decrease can be attributed to lower subscription revenue in our Christian Networks and Jewish Networks segments.

Christian Networks revenue decreased 8.6% to \$27.7 million in the nine months ended September 30, 2014 as compared to \$30.3 million in the same period in 2013. This decline was primarily attributable to a 7.5% decrease in our average paying subscriber base and a 5.1% decrease in average revenue per user per month ("ARPU"). The lower average paying subscriber base reflects the affiliate-driven email deliverability issue described above as well as the reduction and reallocation of our direct marketing investments. The lower ARPU reflects a 16.0% increase in the six-month average paying subscriber base as a percentage of the total average paying subscriber base in the first nine months of 2014 when compared to the same period in the prior year. Additionally, the ARPU for six month plans in the first nine months of 2014 was 3.5% lower than the same period in the prior year, reflecting a higher number of promotional campaigns.

Revenue for the Jewish Networks segment decreased 8.3% to \$17.7 million in the first nine months of 2014 as compared to \$19.3 million in the same period in 2013. The decline was primarily attributable to a 7.0% decrease in average paying subscribers due to the factors noted above.

Revenue for the Other Networks segment decreased 25.7% to \$1.7 million in the first nine months of 2014 as compared to \$2.3 million in the same period in 2013. The decrease in revenue is due to a 27.6% decrease in average paying subscribers, reflecting the elimination of select inefficient online marketing investments.

Revenue for the Offline & Other Businesses segment decreased 11.4% to \$265,000 in the first nine months of 2014 as compared to \$299,000 in the same period of 2013.

##### Cost and Expenses



Cost and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Cost and expenses in the first nine months of 2014 were \$51.5 million, a decrease of 15.2% as compared to \$60.8 million in the same period in 2013. The decrease is primarily attributable to a \$13.8 million decrease in cost of revenue, offset by a \$3.8 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 for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue decreased 32.9% to \$28.2 million in the first nine months in 2014 as compared to \$42.0 million in the same period in 2013. This decrease can be primarily attributed to lower Christian Networks direct marketing expenses. Direct marketing expenses for the Christian Networks segment decreased 38.0% to \$22.5 million in the first nine months in 2014 as compared to \$36.2 million in the same period in 2013. The lower direct marketing expenses reflect lower online and offline advertising spend as we reduce and reallocate our marketing investments to more efficient channels, partners and programming.

**Sales and marketing.** Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses increased 8.2% to \$4.3 million in the first nine months in 2014 as compared to \$4.0 million in the same period in 2013. The increase can be primarily attributed to growth in compensation expenses and consulting fees. Compensation expense increased by approximately \$120,000 as we expanded our mobile product team. Consulting fees increased by approximately \$203,000, primarily reflecting the costs associated with services provided by a media attribution consulting firm.

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 7.1% to \$2.3 million in the first nine months in 2014 as compared to \$2.1 million in the same period in 2013. The expense increase is primarily attributed to higher compensation costs, reflecting increased support for our 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 increased 3.4% to \$917,000 in the first nine months in 2014 as compared to \$887,000 in the same period in 2013. The increase is primarily due to lower capitalized software development costs in the first nine months in 2014 as compared to the same period in 2013.

Development. Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our websites and services. Development expenses increased 13.5% to \$2.6 million in the first nine months in 2014 as compared to \$2.3 million in the same period in 2013. The increased costs reflect higher compensation expense associated with the expansion of our mobile development team.

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 48.9% to \$11.5 million in the first nine months in 2014 as compared to \$7.7 million in the same period in 2013. The increase can be primarily attributed to \$1.2 million of cash compensation associated with the separation of our former chief executive officer and general counsel, proxy contest fees and expenses incurred by the Company totaling approximately \$1.4 million, the reimbursement of certain dissident shareholder proxy contest fees and expenses totaling approximately \$509,000 and approximately \$480,000 related to various corporate legal and litigation matters.

Depreciation. Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expenses increased 7.2% to \$1.6 million in the first nine months in 2014 as compared to \$1.5 million in the same period in 2013. The increase was primarily attributable to higher capitalized software costs.

Amortization of intangible assets. Amortization expenses consist primarily of amortization of intangible assets related to previous acquisitions. The Company recorded \$30,000 for amortization expenses in the first nine months in 2014 as compared to \$10,000 in the same period in 2013. The amortization expense is related to an acquisition consummated in the third quarter of 2013.

Impairment of long-lived assets. Impairment of long-lived assets primarily represents the write-down of investments in businesses and computer software. The Company recorded a \$103,000 impairment expense in the nine months ended September 30, 2014, as compared to \$265,000 in the same period of 2013. In the third quarter of 2014, we wrote-off the fully unamortized balance of capitalized software development costs associated with certain mobile products. In the second quarter of 2013, we impaired \$265,000 of fully unamortized capitalized software costs related to certain web-based products that failed to perform to company standards.

Interest expense (income) and other, net. Interest expense (income) and other, net consists 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 the borrowings from our revolving credit facility. Interest expense (income) and other, net was \$323,000 of expense in the first nine months in 2014 as compared to \$172,000 of income in the same period in 2013. Currency translation adjustments associated with our inter-company loan account for the difference between the two periods.

Provision for income taxes. We did not recognize a tax benefit for losses incurred in the nine months ended September 30, 2014, as we recorded a valuation allowance against our deferred tax assets. We recorded a provision for income taxes of \$507,000 in the first nine months in 2014 which consists of \$269,000 of deferred tax related to an increase in the deferred tax liability associated with tax deductible amortization of goodwill and other indefinite lived intangibles, \$174,000 of foreign and state current tax and \$64,000 related to interest accrued on uncertain tax positions.

Net loss. Net loss was \$5.0 million and \$8.8 million in the nine months ended September 30, 2014 and 2013, respectively. A \$9.0 million increase in contribution, offset by a \$3.8 million increase in general and administrative expenses in the first nine months in 2014 accounted for the lower net loss.

#### Liquidity and Capital Resources

As of September 30, 2014, we had cash and cash equivalents of \$9.3 million. We have historically financed our operations with internally generated funds.

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Net cash used in operations was \$3.8 million in the first nine months in 2014 as compared to \$5.5 million for the same period in 2013. The change primarily resulted from a lower net loss.

Net cash used in investing activities was \$1.9 million in the first nine months in 2014 as compared to \$2.5 million in the same period in 2013. The decrease reflects the absence of leasehold improvements and furniture purchases associated with our relocation to a new corporate office in 2013.

Net cash provided by financing activities was \$238,000 in the first nine months in 2014 as compared to \$14.8 million in the same period in 2013. Cash provided by financing activities in the first nine months in 2014 primarily reflects \$1.7 million in proceeds from the exercise of stock options, offset by \$1.5 million in common stock repurchases. Cash provided by financing activities in the first nine months in 2013 reflects the net proceeds received from the issuance of stock in a public offering of \$12.3 million and the exercise of stock options of \$2.5 million.

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") which changed 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.

As of September 30, 2014, there was no outstanding amount under the Credit Agreement. Additionally, we were in compliance with all customary affirmative and negative covenants as of September 30, 2014. However, subsequent to September 30, 2014, management determined it may achieve compliance with the minimum quarterly revenue covenant for the fourth quarter ending December 31, 2014. The Company will be discussing an amendment to the Credit Agreement with Bank of America.

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.

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.

#### Contractual Obligations

For information about contractual obligations, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2013 Form 10-K. There have been no material changes in contractual obligations outside the ordinary course of business since December 31, 2013.

### ITEM 3. Quantitative AND Qualitative Disclosures About Market Risk

#### Foreign Currency Exchange Risk

Various transactions (including sales, operating expenses and tax liabilities) that occur primarily in Israel are denominated in the New Israeli Shekel and are exposed to exchange rate fluctuations when converted to our reporting currency. As a result, our earnings are at risk as it relates to exchange rate fluctuations. We are also subject to certain translation and economic exposures related to the net investment in our Israeli subsidiary.

A relatively small amount of our monetary assets and liabilities are denominated in foreign currencies, principally the New Israeli Shekel. Fluctuations in these currencies relative to the United States Dollar will result in transaction gains or losses included in net earnings.

As of September 30, 2014, we held cash funds of approximately \$322,000 USD denominated in the New Israeli Shekel. We did not hold any amounts of other foreign currencies. If rates of the New Israeli Shekel were to strengthen or weaken relative to the United States Dollar, we would realize gains or losses in converting these funds back into United States Dollars.

### ITEM 4. CONTROLS AND PROCEDURES

#### (a) 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, our CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2014.

#### (b) Changes in internal control over financial reporting

There have not been any changes in our 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, our internal control over financial reporting.

#### (c) Implementation of new internal controls framework

Due to resource constraints, management has elected to postpone implementation of the Internal Control — Integrated Framework (2013 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) until calendar year 2015. For the year ended December 31, 2014, management will use the criteria established in the Internal Control—Integrated Framework (1992 framework) to conduct its evaluation of the effectiveness of the Company’s internal control over financial reporting.



Part II. Other information

ITEM 1. 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. By written order dated August 30, 2012, the Court set the action for trial on February 24, 2014. On September 4, 2012, Spark Networks filed its Answer to the Complaint. On January 22, 2014, the court entered an Amended Scheduling Order continuing the commencement of the trial to July 21, 2014. The matter was tried before the Honorable David C. Godbey from July 21-22, 2014. On September 19, 2014, the court issued a Final Judgment in favor of Spark Networks and ruling that ISYSTEMS takes nothing by its claims, which were dismissed with prejudice. On October 17, 2014, ISYSTEMS filed a Motion for a New Trial. No ruling on ISYSTEMS’ Motion for a New Trial has been issued to date.

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 others 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 (“Spark Networks”) for violations of California Business & Professions Code section 17529.5. Plaintiffs allege that certain e-mail communications advertising websites of Spark Networks 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. The e-mail publishers responsible for distributing the e-mails at issue in this litigation agreed to furnish a complete defense to the Spark Networks,



through independent counsel at their own expense, pursuant to contractual indemnification provisions. The parties reached a settlement to resolve the action on a classwide basis. They have executed a settlement agreement and filed the necessary approval paperwork with the court. The court granted plaintiffs' motion for preliminary approval of the settlement on October 14, 2014. Notice to putative class members began on October 24, 2014, and the court has scheduled a hearing for final approval of the settlement on February 3, 2015.

At this time, the Company does not anticipate that its liability will exceed \$75,000 if this settlement agreement is approved by the Court.

#### 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.

The parties agreed to a confidential settlement to resolve their dispute for an amount less than the past due invoices, and the case (including all claims and cross-claims) was dismissed in its entirety on May 23, 2014.

#### 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 (the “Werner Complaint”) in the Superior Court for the State of California, County of Los Angeles against Spark Networks, Inc. and Spark Networks USA, LLC (collectively “Spark Networks”). The Werner Complaint alleges that Spark Networks’ website ChristianMingle.com violates California’s Unruh Civil Rights Act (the “Unruh Act”) by allegedly discriminating on the basis of sexual orientation. The Werner Complaint requests the following relief: an injunction, statutory, general, compensatory, treble and punitive damages, attorneys’ fees and costs, pre-judgment interest, and an award for any other relief the Court deems just and appropriate. On December 23, 2013, Richard Wright, on behalf of himself and all other similarly situated individuals, filed a putative Class Action Complaint (the “Wright Complaint”) in the Superior Court for the State of California, County of San Francisco against Spark Networks, Inc. The Wright Complaint alleges that Spark Networks’ commercial dating services including ChristianMingle.com, LDSSingles.com, CatholicMingle.com, BlackSingles.com, MilitarySinglesConnection.com and AdventistSinglesConnection.com violate the Unruh Act by allegedly intentionally and arbitrarily discriminating on the basis of sexual orientation. The Wright Complaint requests the following relief: a declaratory judgment, a preliminary and permanent injunction, statutory penalties, reasonable attorneys’ fees and costs, pre-judgment interest, and an award for any other relief the Court deems just and appropriate. These matters are temporarily stayed while the parties explore whether an agreed upon resolution is possible.

#### Israeli Consumer Actions

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

Three class action law suits 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. (“Spark Networks”) 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 Networks 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 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 Networks 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 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. On May 8, 2014, the Court granted Spark Networks’ motion to consolidate all three cases. All three cases are now consolidated and will be litigated jointly. Spark Networks’ combined response to their motions to certify the classes was filed November 1, 2014.

Please refer to the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 for a description of additional litigation and claims.

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 1A. RISK FACTORS

Except as described below, there have been no material changes from the risk factors disclosed in the “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 31, 2013.

Our principal stockholders, two of whom are affiliated with members of our Board, 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 August 8, 2014, Spruce House Capital LLC, North Run Advisors, LLC, 402 Capital and Osmium Partners and their respective affiliates beneficially owned approximately, in the aggregate, over one-third of our outstanding common stock. These stockholders together possess significant influence over our company. Osmium Partners and 402 Capital were involved in a proxy contest in connection with the election of directors at our 2014 Annual Meeting of Stockholders.

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. In addition, there can be no assurance that conflicts of interest will not arise with respect to the officers and directors who own shares of our common stock or that conflicts will be resolved in a manner favorable to us or our other stockholders.

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 Board of Directors.

There are no cumulative voting rights provided for in our bylaws or certificate of incorporation. While we have recently amended our bylaws to enable stockholders to call special meetings, our certificate of incorporation and bylaws still 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 for beneficial stockholders 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.

We added six new directors to our Board of Directors in the third quarter of 2014, which may lead to changes in the execution of our business strategies and objectives.

In connection with our contested annual meeting of stockholders on June 27, 2014, four new directors were elected, one long-time director subsequently resigned and another new director was appointed to the Board pursuant to a solicitation agreement between our two largest stockholders, Osmium Partners and 402 Capital. The one continuing director, David Hughes, resigned on September 12, 2014 and was replaced by Jonathan R. Mather. Because of these changes, our Board has not worked together as a group for an extended period of time. Furthermore, none of the directors has worked with management or the Company for an extended period of time. These changes in our Board of Directors may lead to delays or changes in the execution of our business strategies and objectives and the development of new strategic initiatives as our new directors analyze our business and contribute to the formulation of our business strategies and objectives. In addition, these changes may adversely affect our ability to retain and attract experienced executives and employees.

Our former CEO and General Counsel separated from the Company and the majority of our Board of Directors was elected in connection with an extended proxy contest and has not previously worked with the Company nor our remaining current management team, which may lead to challenges in retaining key employees.

Our former CEO and General Counsel entered into separation and release agreements with the Company, with separation dates of August 11 and August 12, 2014, respectively. In connection with our contested annual meeting of stockholders on June 27, 2014, four new directors were elected, one long-time director subsequently resigned and another new director was appointed to the Board pursuant to a solicitation agreement between our two largest stockholders, Osmium Partners and 402 Capital. The one continuing director, David Hughes, resigned on September 12, 2014 and was replaced by Jonathan R. Mather. As a result of the changes in our Board, none of the directors has worked with the remaining management or the Company in the past and there can be no assurances they will be able to effectively do so. As a result, the change in control of the Board may adversely affect our ability to retain certain of our key employees.

The conflicts between Israel and Hamas could have a material adverse impact upon our business and operating results.

We maintain physical operations in Israel and our Hebrew language sites, JDate.co.il and Cupid.co.il, represent approximately 15% of our Jewish Networks revenue. As a result, the conflicts between Israel and Hamas could impact our employees, operations and our members' and potential members' interest in our services, and may have a material impact upon our subscriber and revenue bases as conflict occurs.

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

On December 16, 2013, we announced that 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 we deem 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 our sole discretion. We are 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.

During the nine months ended September 30, 2014, we made the following stock repurchases:

| Period                   | Total number of Shares Purchased | Weighted Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Amount of Shares that May yet be Purchased Under the Plans or Programs |
|--------------------------|----------------------------------|---------------------------------------|--|---|
| (2014)<br>Jan 1 – Jan 31 | 43,167                           | \$5.87                                | 43,167   | 4,746,787   |
| Feb 1 - Feb 28           | 135,180                          | \$5.81                                | 135,180  | 3,960,783   |
|                          | 92,770                           | \$4.88                                | 92,770   | 3,508,136   |

|                     |         |        |         |           |
|---------------------|---------|--------|---------|-----------|
| Mar 1 – Mar<br>31   |         |        |         |           |
| Apr 1 – June<br>30  | -       | -      | -       |           |
| July 1 – Sept<br>30 | -       | -      | -       |           |
| Total               | 271,117 | \$5.50 | 271,117 | 3,508,136 |

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

None.

## ITEM 5. OTHER INFORMATION

On February 13, 2014, we executed a Sixth Amendment to the Credit Agreement with Bank of America which changed 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, 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.

ITEM 6. EXHIBITS

(a) Exhibits:

| Exhibit<br>No. | Description  |
|----------------|--|
| 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.



SIGNATURES

Pursuant to the requirements 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.

SPARK NETWORKS, INC.

/s/ Brett A. Zane

by: Brett A. Zane  
Chief Financial Officer  
(Principal financial officer and duly authorized signatory)

Date: November 6, 2014