

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

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NO. 001-32750

**SPARK NETWORKS, INC.**  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

20-8901733  
(I.R.S. Employer  
Identification No.)

8383 Wilshire Boulevard, Suite 800, Beverly Hills,  
California  
(Address of principal executive offices)

90211  
(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (323) 658-3000

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

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

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

None.

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

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

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

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

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

The aggregate market value of the voting and non-voting common equity (which consists solely of shares of common stock) held by non-affiliates of the registrant as of June 30, 2012 was approximately \$59,805,515 based on \$5.16, the closing price of the registrant's common stock on the NYSE MKT on June 29, 2012.

The registrant had 20,958,489 outstanding common stock, par value \$0.001 per share, as of March 8, 2013.

Information required by Items 10, 11, 12, 13 and 14 of Part III are incorporated by reference from the Proxy Statement for the registrant's 2013 Annual Meeting of Stockholders. Except with respect to information specifically incorporated by reference in the Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

[Table of Contents](#)

**SPARK NETWORKS, INC.**  
**TABLE OF CONTENTS TO ANNUAL REPORT ON FORM 10-K**  
**For the Fiscal Year Ended December 31, 2012**

<u>ITEM</u>		<u>Page</u>
<b><u>PART I</u></b>		
Item 1.	<a href="#">Business</a>	4
Item 1A.	<a href="#">Risk Factors</a>	9
Item 1B.	<a href="#">Unresolved Staff Comments</a>	22
Item 2.	<a href="#">Properties</a>	22
Item 3.	<a href="#">Legal Proceedings</a>	22
Item 4.	<a href="#">Mine Safety Disclosures</a>	23
<b><u>PART II</u></b>		
Item 5.	<a href="#">Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</a>	24
Item 6.	<a href="#">Selected Financial Data</a>	24
Item 7.	<a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	25
Item 7A.	<a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>	38
Item 8.	<a href="#">Financial Statements and Supplementary Data</a>	38
Item 9.	<a href="#">Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</a>	38
Item 9A.	<a href="#">Controls and Procedures</a>	38
Item 9B.	<a href="#">Other Information</a>	39
<b><u>PART III</u></b>		
Item 10.	<a href="#">Directors, Executive Officers and Corporate Governance</a>	40
Item 11.	<a href="#">Executive Compensation</a>	40
Item 12.	<a href="#">Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</a>	40
Item 13.	<a href="#">Certain Relationships and Related Transactions, and Director Independence</a>	40
Item 14.	<a href="#">Principal Accounting Fees and Services</a>	40
<b><u>PART IV</u></b>		
Item 15.	<a href="#">Exhibits and Financial Statement Schedules</a>	41
	<a href="#">Signatures</a>	45

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

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

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

- our ability to attract members to our Web sites, convert members into paying subscribers and retain our paying subscribers;
- the highly competitive nature of our business;
- our ability to keep pace with rapid technological change and enhance existing or introduce new services;

---

## **Table of Contents**

- the strength of our existing brands and our ability to maintain and enhance those brands;
- our ability to effectively manage our operations and attract and retain qualified personnel;
- our dependence upon the telecommunications infrastructure and our networking hardware and software infrastructure;
- effectively protecting our internet domain names and proprietary rights;
- the effect of new or interpretation of existing laws and regulations on our operations;
- the volatility of the price of our equity securities; and
- other factors referenced in this annual report on Form 10-K and other reports.

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

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

### **ADDITIONAL INFORMATION**

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

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

## PART I

### ITEM 1. BUSINESS

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

#### Our Business

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

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

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

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

#### Our Industry

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

#### Our Competitive Strengths

- **Strength of the ChristianMingle and JDate Brands.** We believe ChristianMingle and JDate, with their strong brand recognition, are valuable assets. We believe the size and strength of each of our key brands will allow us to market to and serve each of the Christian and Jewish communities profitably. Because of the strength of our brands, we believe we are not required to spend as much on marketing them as we may on some of our lesser-known brands, or as much as others in the industry may spend on their personals Web sites.
- **Affinity-Focused Communities.** We believe singles are more likely to interact, find friends and form lasting relationships with like-minded individuals who share common values, beliefs, traditions and cultural upbringings. For this reason, the majority of our Web sites are targeted to specific religious, ethnic, geographic and special interest groups. We believe our targeted communities enjoy greater word-of-mouth recognition and consumer loyalty relative to non-targeted communities.
- **Web Site Functionality.** We continually evaluate the functionality of our Web sites to improve our members' experiences. Many of the features we offer, such as onsite emails, real-time chat rooms, instant messaging, E-cards and message boards increase the probability of communication between our members, which we believe increases the number and percentage of members who become and remain paying subscribers.
- **Customer Service Focus.** Our multi-lingual call centers and email support team monitor our sites for fraudulent activity, assist members with billing questions, help members complete personal profiles and answer technical questions. We believe the quality of our customer service increases member satisfaction, which increases the number and percentage of members that become and remain paying subscribers.

#### Our Online Personals Services

Our online personals services offer single adults a convenient and secure setting for meeting other singles. Visitors to our Web sites are encouraged to become registered members and post profiles. Posting a profile is a process in which visitors are asked various questions about themselves, including information such as their tastes in food, hobbies and desired attributes of

---

## Table of Contents

potential partners. Members may also post photos of themselves. Members can perform detailed searches of other profiles and save their preferences, and their profiles can be viewed by other members. In most cases, for a member to initiate email and instant message communication with others, that member must purchase a subscription. A subscription affords access to the paying subscribers' on-site email, instant messaging systems, message boards and chat rooms, enabling such subscribers to communicate with other members and paying subscribers. Our subscription fees are charged on a monthly basis, with discounts for longer-term subscription purchases.

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

<u>Online Personals Web Site</u>	<u>Target Audience</u>
<b>Jewish Networks</b>	
JDate.com	Jewish singles
JDate.co.uk	Jewish singles
JDate.fr	Jewish singles (French speakers)
JDate.co.il	Jewish singles (Hebrew speakers)
Cupid.co.il	Jewish singles (Hebrew speakers)
<b>Christian Networks</b>	
ChristianMingle.com	Christian singles
ChristianMingle.co.uk	Christian singles
ChristianMingle.com.au	Christian singles
<b>Other Networks</b>	
AdventistSinglesConnection.com	Adventist singles
BBWPersonalsPlus.com	Big beautiful women and admirers
BlackSingles.com	African-American singles
CatholicMingle.com	Catholic singles
DeafSinglesConnection.com	Deaf singles
InterracialSingles.net	Interracial singles
LDSMingle.com	Mormon singles
LDSingles.com	Mormon singles
MilitarySinglesConnection.com	Military singles
SilverSingles.com	Mature singles
Spark.com	Non-targeted
<b>Offline and Other Businesses</b>	
HurryDate.com	Rapid dating and offline events
Matchnet.com	Free dating search engine
Facelink.com	Free dating search engine

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

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

---

## Table of Contents

- *Hot Lists and Favorites.* “Hot Lists” enable members to see who is interested in them and to save those favorite members in whom they are interested. Lists include (1) who has viewed your profile, (2) your favorites and (3) who has emailed you. Members can also group their favorites into customized folders and add their own notes, including details included in a member’s profile.
- *Message Boards.* Message Boards enable paying subscribers to communicate in a group environment with suggested topics for discussion.
- *Real-Time Chat Rooms.* Paying subscribers can use our exclusive chat rooms to mix and mingle in real-time, building a sense of community through group discussions. Additional features enable users to add customized graphics such as emoticons to their conversations.
- *Ice Breakers.* Members can send pre-packaged opening remarks, referred to on the Web sites as “flirts” and “smiles,” to other members or paying subscribers.
- *Click!* Our patented *Click!* feature connects members who think they would be compatible with each other. A member clicks “yes,” “no” or “maybe” in another member’s profile. When two members click “yes” in each other’s profiles, our patented feature sends an email to both of them alerting them of the match.

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

### **Business Strategy**

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

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

- *Integrated and targeted marketing.* We believe targeting potential members with consistent and compelling marketing messages, delivered through a broad mix of marketing channels, will be effective in driving more traffic and a higher percentage of relationship-oriented singles to our Web sites. We intend to use a variety of channels to build our brands and increase our base of subscribers including online and offline advertising, customer relationship management tools, public relations, promotional alliances and special events.
- *Cross-promote.* Our large base of members provides us with a significant amount of consumer data to evaluate cross-promotion opportunities for growth. We are able to analyze different groups of members by key metrics such as total potential subscribers and average revenue per paying subscriber and identify those targeted groups that may prefer a service dedicated to their particular affinity groups.

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

- *Improved member communications.* We believe enhanced member communications is a key component to growing our business. We continue to focus on improving and enhancing our Web site functionality and features to encourage communications between members. Most of these communications require members to become paying subscribers. We will also continue to inform members of new features and functionality to increase the number of visitors to our Web sites who become paying subscribers.
- *Improved search.* We believe the more successful members are in finding matches in our database, the more likely they are to want to communicate with those members and to refer their friends to our Web sites. To initiate email and instant message communication or participate in the chat rooms or message boards, members must become paying subscribers. We intend to continue to enhance the quality and relevance of our search results to provide faster, more relevant suggestions.
- *Leveraging strong customer service.* Each time a member or a potential member contacts our customer service center by email or phone, he or she represents a potential new paying subscriber. By training our customer service representatives on upselling opportunities, we believe they will continue to be successful in selling our services.

---

## [Table of Contents](#)

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

### **Sales and Marketing**

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

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

### **Customer Service**

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

### **Technology**

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

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

### **Intellectual Property**

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

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

---

## [Table of Contents](#)

### **Competition**

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

### **Government Regulation**

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

### **Employees**

As of December 31, 2012, we had 182 full-time equivalent employees. We are not subject to any collective bargaining agreements and we believe our relationship with our employees is good.

---

## Table of Contents

### **ITEM 1A. RISK FACTORS**

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

#### **Risks Related to Our Business**

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

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

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

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

We have historically generated significant operating losses in some years. As of December 31, 2012, we had an accumulated deficit of approximately \$44.0 million. We had net (loss) income of approximately (\$15.0), (\$1.6) and \$3.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. If our revenue does not grow at a substantially faster rate than our operating expenses, or if our operating expenses are higher than we anticipate, or if our revenue begins to decline but our operating expenses increase, we may not be profitable and we may incur additional losses, which could be significant.

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

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

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

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

---

## [Table of Contents](#)

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

The majority of our revenue is generated by internet users that pay us a subscription fee. One of our key performance metrics focuses on the average number of paying subscribers in a given period. The number of monthly average paying subscribers is calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in the period. Internet users, in general, and users of online personals services specifically, freely navigate and use the services offered by a variety of Web sites. We cannot assure you that our monthly average paying subscriber numbers will remain at consistent levels, and they may decrease in the future, thus decreasing our revenue. In 2012, average paying subscribers increased 32.0% and revenue also increased 27.3% compared to 2011. If we do not constantly attract new paying subscribers at a faster rate than subscription terminations, our average paying subscribers will decrease and we will not be able to maintain or increase our current level of revenue.

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

Costs for us to acquire paying subscribers are dependent, in part, upon our ability to purchase advertising at a reasonable cost. Our advertising costs vary over time, depending upon a number of factors, many of which are beyond our control. Historically, we have used online and offline advertising as the primary means of marketing our services. During 2012, our cost of revenue substantially increased, primarily as a result of higher direct marketing expenses related to our Christian Networks.

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

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

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

In February 2008, we entered into an initial credit agreement with Bank of America under which we had no outstanding borrowings as of December 31, 2012. If we are unable to pay our debts as they become due, we will be required to pursue one or more alternative strategies, such as refinancing or restructuring our indebtedness, selling additional debt or equity securities or selling assets. We may not be able to refinance our debt or issue additional debt or equity securities on favorable terms, if at all, and if we must sell our assets, it may negatively affect our ability to generate future revenue. If we are unable to meet our obligations as they become due or to comply with various financial covenants contained in the revolving credit facility, this could constitute an event of default.

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

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

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

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

---

## **Table of Contents**

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

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

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

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

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

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

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

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

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

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

We operate in a market characterized by rapidly changing technologies, evolving industry standards, frequent new product and service announcements, enhancements and changing customer demands. Accordingly, our performance will depend on

---

## Table of Contents

our ability to adapt to rapidly changing technologies and industry standards, and our ability to continually improve the speed, performance, features, ease of use and reliability of our services in response to both evolving demands of the marketplace and competitive service and product offerings. There have been occasions when we have not been as responsive as many of our competitors in adapting our services to changing industry standards and the needs of our members and paying subscribers. Our industry has been subject to constant innovation and competition. New features may be introduced by one competitor, and if they are perceived as attractive to users, they are often copied later by others. Over the last few years, such new feature introductions in the industry have included instant messaging, message boards, E-cards, personality profiles and mobile content delivery. Introducing new technologies into our systems involves numerous technical challenges, substantial amounts of capital and personnel resources and often takes many months to complete. We intend to continue to devote efforts and funds toward the development of additional technologies and services. For example, in 2012 and 2011 we introduced a number of new features, and we anticipate the introduction of additional features in 2013 and 2014. We may not be able to effectively integrate new technologies into our Web sites on a timely basis or at all, which may degrade the responsiveness and speed of our Web sites. Such technologies, even if integrated, may not function as expected.

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

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

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

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

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

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

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

Furthermore, we rely on many different hardware systems and software applications, some of which have been developed internally. If these hardware systems or software applications fail, it would adversely affect our ability to provide our services. If we are unable to protect our data from loss or electronic or magnetic corruption, or if we receive a significant unexpected increase in usage and are not able to rapidly expand our transaction-processing systems and network

---

## **Table of Contents**

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

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

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

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

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

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

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

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

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

---

## **Table of Contents**

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

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

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

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

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

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

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

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

---

## [Table of Contents](#)

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

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

- the demand for, and acceptance of, our online personals services and enhancements to these services;
- the timing and amount of our subscription revenue;
- the introduction, development, timing, competitive pricing and market acceptance of our Web sites and services and those of our competitors;
- the magnitude and timing of marketing initiatives and capital expenditures relating to expansion of our operations;
- the cost and timing of online and offline advertising and other marketing efforts;
- the maintenance and development of relationships with portals, search engines, ISPs and other Web properties and other entities capable of attracting potential members and paying subscribers to our Web sites;
- technical difficulties, system failures, system security breaches, or downtime of the Internet, in general, or of our products and services, in particular;
- costs related to any acquisitions or dispositions of technologies or businesses;
- fluctuations in foreign exchange rates; and
- general economic conditions, as well as those specific to the Internet, online personals and related industries.

As a result of the factors listed above and because the online personals business is still immature, making it difficult to predict consumer demand, it is possible that in future periods results of operations may be below the expectations of public market analysts and investors. This could cause the market price of our securities to decline.

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

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

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

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports, effectively prevent fraud and operate as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We have, in the past, discovered and may, in the future, discover areas of our internal controls over financial reporting that need improvement. As a U.S. public company, we are subject to the reporting requirements of the Sarbanes-Oxley Act of 2002. We are required to annually assess and report on our internal controls over financial reporting. If we are unable to adequately maintain or improve our internal controls over financial reporting, we may report that our internal controls are ineffective. Ineffective internal controls over financial reporting could also cause investors to lose confidence in our reported financial information which would likely have a negative effect on the trading price of our securities or could affect our ability to access the capital markets and which could result in regulatory proceedings against us by, among others, the U.S. Securities Exchange Commission.

---

## **Table of Contents**

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

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

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

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

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

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

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

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

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

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

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

---

## [Table of Contents](#)

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

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

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

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

### **Risks Related to Our Industry**

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

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

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

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

The nature of online personals services is such that we cannot control the actions of our members and paying subscribers in their communication or physical actions. There is a possibility that one or more of our members or paying subscribers could be physically or emotionally harmed following interaction with another one of our members or paying subscribers. We warn our members and paying subscribers that we do not conduct background checks on other members and paying subscribers

---

## [Table of Contents](#)

and, given our lack of physical presence, we do not take any action to ensure personal safety on a meeting between members or paying subscribers arranged following contact initiated via our Web sites. If an unfortunate incident of this nature occurred in a meeting of two people following contact initiated on one of our Web sites or a Web site of one of our competitors, any resulting negative publicity could materially and adversely affect us or the online personals industry in general. Any such incident involving one of our Web sites could damage our reputation and our brands. This, in turn, could adversely affect our revenue and could cause the value of our common stock to decline. In addition, the affected members or paying subscribers could initiate legal action against us, which could cause us to incur significant expense, whether we were successful or not, and damage our reputation.

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

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

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

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

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

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

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

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

---

## Table of Contents

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

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

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

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

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

Furthermore, in part as a result of current economic conditions, some states have begun to, and others may in the future, impose state taxes on services provided through the Internet, such as online personals, which will increase the cost of our services and could adversely affect our business. Any legislation and regulations enacted or newly enforced or restrictions arising from current or future government investigations or policy could dampen the growth in use of the Internet, generally, decrease the profitability of Internet related businesses and diminish the acceptance of the Internet as a communications, commercial, entertainment, recruiting and advertising medium. In addition to new laws and regulations being adopted, existing laws that are not currently being applied to the Internet may subsequently be applied to it, in some cases with a retroactive effect or penalty, and, in several jurisdictions, legislatures are considering laws and regulations that would apply to the online personals industry in particular. Many areas of law affecting the Internet and online personals

## [Table of Contents](#)

remain unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws such as those governing consumer protection, intellectual property, libel and taxation apply to the Internet or to our services. In the normal course of our business, we handle personally identifiable information pertaining to our members and paying subscribers residing in the United States and other countries. In recent years, many of these countries have adopted privacy, security and data protection laws and regulations intended to prevent improper uses and disclosures of personally identifiable information. In addition, some jurisdictions impose database registration requirements for which significant monetary and other penalties may be imposed for noncompliance. These laws may impose costly administrative requirements, limit our handling of information, and subject us to increased government oversight and financial liabilities. Privacy laws and regulations in the United States and foreign countries are subject to change and may be inconsistent, and additional requirements may be imposed at any time. These laws and regulations, the costs of complying with them, administrative fines for noncompliance and the possible need to adopt different compliance measures in different jurisdictions could materially increase our expenses and cause the value of our securities to decline.

### **Risks Related to Owning Our Securities**

#### **The price of our stock may be volatile, and if an active trading market for our stock does not develop, the price of our stock may suffer and decline.**

In July 2007, we completed the Scheme of Arrangement of Spark Networks plc to become the Company's wholly-owned subsidiary. The American Depositary Shares representing ordinary shares of Spark Networks plc began trading on the American Stock Exchange (now NYSE MKT) in February 2006 and our shares of common stock began trading in July 2007 after the completion of our Scheme of Arrangement. Prior to that, there was no public market for our securities in the United States. Accordingly, we cannot assure you that an active trading market will develop or be sustained or that the market price of our common stock will not decline. The price at which our common stock trades is likely to be highly volatile and may fluctuate substantially due to many factors, some of which are outside of our control. In addition, the stock market has experienced significant price and volume fluctuations that have affected the market price for the stock of many technology, communications and entertainment and media companies. Those market fluctuations were sometimes unrelated or disproportionate to the operating performance of these companies. Any significant stock market fluctuations in the future, whether due to our actual performance or prospects or not, could result in a significant decline in the market price of our securities.

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

As of March 8, 2013, Great Hill Investors, LLC, North Run Advisors, LLC, and Osmium Partners, LLC and their respective affiliates beneficially owned approximately, in the aggregate, 65.2% of our outstanding common stock. Great Hill Investors, LLC and its affiliates ("Great Hill") became our largest stockholder on December 1, 2005 when it purchased an aggregate of 6,000,000 ordinary shares in four privately negotiated transactions and it subsequently acquired an additional 3,085,000 shares. Great Hill and its affiliates held an aggregate of 9,085,000 shares of common stock as of March 8, 2013. These stockholders possess significant influence over our company. Such ownership and control may have the effect of delaying or preventing a change in control of our company, impeding a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company. Furthermore, such ownership may have the effect of control over substantially all matters requiring stockholder approval, including the election of directors. Other than the arrangement to elect a director at the selection of Great Hill which affects some of these stockholders, as discussed below, we do not expect that these stockholders will vote together as a group. It should be noted that Great Hill Investors, LLC ownership information is based on a Schedule 13D/A filed with the SEC on March 2, 2010, North Run Advisors, LLC ownership information is based on a Schedule 13F filed with the SEC on February 8, 2013 and Osmium Partners, LLC ownership information is based on a Schedule 13G filed with the SEC on February 12, 2013.

#### **Our largest stockholder, Great Hill, also possesses a significant amount of voting power and an ability to elect a director of our company.**

As of March 8, 2013, Great Hill beneficially owned 9,085,000 shares of our common stock, or approximately 43.4% of our outstanding common stock, and may have voting control over additional securities to elect a director of our company subject to the terms and conditions of the share purchase agreements entered into on December 1, 2005 with certain selling stockholders (collectively, the "Selling Stockholders"), to the extent the Selling Stockholders own shares of Spark. Pursuant to the terms of the share purchase agreements with each of the Selling Stockholders, for so long as Great Hill collectively owns at least 10% or 5%, depending on the Selling Stockholder, each Selling Stockholder agreed that:

- if at any time Great Hill notifies a Selling Stockholder of its desire and intention to designate a single director ("Great Hill Director") in advance of any meeting of the stockholders for the election of directors or when any other approval is sought with respect to the election of directors, such Selling Stockholder agreed to vote all of its voting shares that are owned or held of record by such Selling Stockholder or to which it has voting power or can direct, restrict or control any such voting power (the "Remaining Shares") to elect such Great Hill Director; and
- if at any time Great Hill notifies a Selling Stockholder of its desire and intention to remove or replace a Great Hill Director or to fill a vacancy caused by the resignation of a Great Hill Director, such Selling Stockholder agreed to cooperate in causing the requested removal and/or replacement by voting in the appropriate manner.

---

## Table of Contents

Each Selling Stockholder also irrevocably granted, and appointed Michael A. Kumin, and any other person who shall be designated by Great Hill, as such Selling Stockholder's proxy and attorney (with full power of substitution), to vote all of such Selling Stockholder's Remaining Shares held at the time such consent is sought or meeting is held in any circumstances where a vote, consent or other approval is sought to elect a Great Hill Director. The covenants and obligations of each Selling Stockholder terminate after a Great Hill Director (together with any replacements therefore) has served a single, full term of office of three years, in accordance with the articles and memorandum of association, as in effect on December 1, 2005 when our parent entity was Spark Networks plc.

As a result of its voting arrangement with the Selling Stockholders, Great Hill is able to select a member of our board of directors at its discretion and is able to exercise significant influence over our company. This influence has the potential to delay, prevent, change or initiate a change in control, acquisition, merger or other transaction, such as a transaction to take the Company private.

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

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

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

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

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

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

## Table of Contents

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

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

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

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

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

### **ITEM 2. PROPERTIES**

We do not own any real property that is materially important to our business. Our headquarters is currently located in Beverly Hills, California, where we occupy approximately 16,000 square feet of office space, housing our technology department and most of our corporate and administrative personnel. Our current lease for this space runs from August 1, 2011 through July 31, 2013 with monthly base rent starting at \$42,193 for the first year with 4 months of 50% abated rate during the first year of the term, and increasing to \$43,459 for the second year with 8 months of 50% abated rate during the second year of the term. In anticipation of the end of our lease in Beverly Hills, we have entered into a new 5-year lease for approximately 16,000 square feet with monthly basic rent ranging from approximately \$43,117 to \$51,427 and six months of rent abatement. We will relocate our corporate, administrative, technology and development personnel to the new office space prior to the expiration of the Beverly Hills lease. We also lease office space in Utah and Israel and datacenter space in California and Utah. We believe that our facilities are adequate for our current needs and suitable additional or substitute space will be available in the future to replace our existing facilities, if necessary, or accommodate expansion of our operations.

### **ITEM 3. LEGAL PROCEEDINGS**

*ISYSTEMS v. Spark Networks, Inc. et al.*

On July 11, 2008, ISYSTEMS initiated a lawsuit against Spark Networks, Inc. and Spark Networks Limited (collectively, “Spark Networks”) and other parties in the United States District Court, Northern District of Texas, Dallas Division. The lawsuit was filed in response to an arbitration award ordering the transfer of the domain name, JDATE.NET, to Spark Networks Limited from ISYSTEMS. Spark Networks was apprised of the lawsuit after ISYSTEMS unsuccessfully attempted to utilize the filing of the lawsuit to prevent the domain transfer to Spark Networks Limited. On December 1, 2008, Spark Networks filed a Motion to Dismiss the Complaint, or, Alternatively, for Summary Judgment. On September 10, 2009, the Court granted Spark Networks’ motion and dismissed the case with prejudice. On September 22, 2009, ISYSTEMS filed a motion to vacate the order dismissing the action and requesting leave to amend its complaint. On October 26, 2009, the Court granted ISYSTEMS’ motion and ISYSTEMS filed its Amended Complaint on November 25, 2009. On January 19, 2010, Spark Networks filed a Motion to Dismiss the Amended Complaint, or Alternatively, for Summary Judgment. The Court granted Spark Networks’ Motion to Dismiss on June 28, 2010 and entered a judgment in favor of Spark Networks. On July 25, 2010, ISYSTEMS filed a motion to vacate the order granting the motion to dismiss, which was denied by the Court on

---

## Table of Contents

August 11, 2010. On September 10, 2010, ISYSTEMS filed a notice of appeal of the district court's order and judgment to the United States Court of Appeals for the Fifth Circuit. On June 13, 2011, the United States Court of Appeals for the Fifth Circuit issued its opinion affirming the District Court's judgment. On June 29, 2011, ISYSTEMS filed a Petition for Rehearing with the United States Court of Appeals for the Fifth Circuit, which was granted. Oral argument was held on December 8, 2011. Per the Fifth Circuit's request, the parties submitted supplemental briefs on December 16, 2011. On March 21, 2012, the Fifth Circuit issued its opinion affirming the District Court's dismissal of certain claims and reversing the dismissal of certain other claims. On April 19, 2012, the matter was remanded back to the District Court. On September 4, 2012, Spark Networks filed its Answer to the Complaint. By written order dated August 30, 2012, the Court set the action for trial on February 24, 2014.

### *B.E. Technology, L.L.C. v. Spark Networks, Inc.*

On September 22, 2012, B.E. Technology, L.L.C. commenced a lawsuit against Spark Networks, Inc. in the Western District of Tennessee, B.E. Technology, L.L.C. v. Spark Networks, Inc., Civil Action No. 2:12-cv-02832-cgc, for alleged infringement of U.S. Patent No. 6,628,314. The patent is entitled "Computer Interface Method And Apparatus With Targeted Advertising." The Complaint alleges that "Spark Networks has infringed at least claim 11 of the '314 patent by using a method of providing demographically targeted advertising," and seeks damages and an injunction. On December 31, 2012, Spark filed an Answer to the Complaint denying that the '314 patent was infringed by Spark and alleging, among other things, that the patent was invalid. On January 7, 2013, B.E. Technology served its Initial Infringement Contentions asserting that Spark had infringed claims 11, 12, 13, 15, 18, 19 and 20. The Company has made a motion to transfer the case to California.

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

On October 16, 2012, Kristina Kirby, Christopher Wagner and Jamie Carper (collectively referred to as "Plaintiffs"), on behalf of themselves and all other similarly situated, filed a putative class action Complaint in the Superior Court for the State of California, County of Los Angeles (Case No. BC493892) alleging claims against Spark Networks USA, LLC for violations of California Business & Professions Code section 17529.5. Plaintiffs allege that certain e-mail communications advertising Web sites of Spark Networks USA, LLC and received by Plaintiffs violate a California statute prohibiting false and deceptive e-mail communications (namely, California Business & Professions Code section 17529.5). Plaintiffs generally allege that they seek damages in excess of \$25,000.

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

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

## **ITEM 4. MINE SAFETY DISCLOSURES**

**Not Applicable.**

**PART II.**

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

**Market Information**

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

	<u>High</u>	<u>Low</u>
<b>Year ended December 31, 2011</b>		
First Quarter	\$3.33	\$3.01
Second Quarter	\$3.33	\$3.11
Third Quarter	\$3.74	\$3.00
Fourth Quarter	\$3.83	\$3.00
	<u>High</u>	<u>Low</u>
<b>Year ended December 31, 2012</b>		
First Quarter	\$4.74	\$3.62
Second Quarter	\$5.73	\$4.24
Third Quarter	\$6.81	\$5.02
Fourth Quarter	\$7.90	\$5.97

**Holders**

As of March 8, 2013 there were 43 holders of record of our common stock.

**Dividends**

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

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

**Securities Authorized for Issuance Under Equity Compensation Plans**

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

**Unregistered Sales of Equity Securities**

During the year ended December 31, 2012, we did not issue unregistered securities.

**Purchases of Equity Securities**

We did not purchase any shares in the year ended December 31, 2012.

**ITEM 6. SELECTED FINANCIAL DATA**

Not applicable for a smaller reporting company

---

## Table of Contents

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

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

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

#### **General**

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

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

For the year ended December 31, 2012, we had 259,244 average paying subscribers, representing an increase of 32.0% from the year ended December 31, 2011. Paying subscribers are defined as individuals who have paid a monthly fee for access to communication and Web site features beyond those provided to our non-paying members. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in such period.

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

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

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

---

## [Table of Contents](#)

### **Critical Accounting Policies, Estimates and Assumptions**

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

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

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

#### ***Revenue Recognition and Deferred Revenue***

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

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

#### ***Cost of Revenue***

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

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

- Cost per subscription (CPS) where we pay an online advertising provider a fee based upon the number of new paying subscribers it generates;
- Cost per acquisition (CPA) where we pay an online advertising provider a fee based on the number of new member registrations it generates;
- Cost per click (CPC) where we pay an online advertising provider a fee based on the number of clicks to our Web sites it generates;
- Cost per thousand for banner advertising (CPM) where we pay an online advertising provider a fee based on the number of times it displays our advertisements; and

---

## **Table of Contents**

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

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

### ***Prepaid Advertising Expenses***

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

### ***Web Site and Software Development Costs***

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

We expense costs related to the planning and post implementation phases of Web site development efforts. Direct costs incurred in the development phase are capitalized. Costs associated with minor enhancements and maintenance for a Web site are included in expenses in the accompanying consolidated statements of operations.

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

We test goodwill and indefinite-lived intangible assets for impairment at least annually, or more frequently when circumstances indicate that the carrying value may not be recoverable and test property, plant and equipment and other intangible assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Factors we consider important and which could trigger an impairment review include the following:

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

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

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

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

As of December 31, 2012, Jewish Networks, Christian Networks and Other Networks carried goodwill balances of \$6.9 million, \$1.7 million and \$232,000, respectively.

---

## **Table of Contents**

In 2011, we impaired approximately \$45,000 of capitalized software development costs when we determined that a Web-based product failed to perform to Company standards. In 2012, an impairment charge was not necessary.

In 2011, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value based upon the expected future cash flows generated from the businesses associated with these assets, resulting in impairment charges of approximately \$1.1 million. In 2012, an impairment charge was not necessary.

### ***Accounting for Business Combinations***

We acquired the stock or specific assets of a number of companies from 1999 through 2008 some of which were considered to be business acquisitions. Under the purchase method of accounting, the costs are allocated to the underlying net assets, based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill.

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

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

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

### ***Legal Contingencies***

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

### ***Accounting for Income Taxes***

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

As of December 31, 2012, we have a valuation allowance against our U.S. and foreign deferred tax assets of approximately \$9.6 million. Companies are required to assess whether a valuation allowance should be recorded against their deferred tax assets (“DTAs”) based on the consideration of all available evidence, using a “more likely than not” realization standard. The four sources of taxable income that must be considered in determining whether DTAs will be realized are, (1) future reversals of existing taxable temporary differences (i.e. offset of gross deferred tax assets against gross deferred tax liabilities); (2) taxable income in prior carryback years, if carryback is permitted under the tax law; (3) tax planning strategies and (4) future taxable income exclusive of reversing temporary differences and carryforwards.

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. We have evaluated our DTAs each reporting period, including an assessment of our cumulative income or loss over the prior three-year period, to determine if a valuation allowance was required. A significant negative factor in our assessment was the Company’s three-year cumulative loss history as of December 31, 2012.

After a review of the four sources of taxable income described above and in view of our three-year cumulative loss, we were not able to conclude that it is more likely than not that our DTAs will be realized. As a result, we recorded an additional valuation allowance on our DTAs, with a corresponding charge to our income tax provision, of approximately \$8.9 million as of December 31, 2012.

At December 31, 2012, we had gross net operating loss (“NOL”) carry-forwards for income tax purposes of approximately \$18.6 million and \$38.4 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2025 for federal purposes and 2018 for state purposes. Under section 382 of the Internal Revenue Code, the utilization of the net operating loss carry-forwards can be limited based on changes in the percentage ownership of the Company.

The Company recognizes excess tax benefits associated with the exercise of stock options directly to stockholders’ equity only when realized. Accordingly, deferred tax assets are not recognized for net operating losses resulting from excess tax benefits. As of December 31, 2012, deferred tax assets do not include approximately \$4.8 million of these excess tax benefits from employee stock option exercises that are a component of the Company’s NOL carry forwards. Additional paid in capital will be increased up to an additional \$4.8 million if and when such excess tax benefits are realized. During 2012, approximately \$23,000 of net excess tax provision was realized.

We operate in multiple taxing jurisdictions, both within the United States and outside the United States. We have filed tax returns with positions that may be challenged by the tax authorities. These positions relate to, among others, transfer pricing,

---

## **Table of Contents**

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

### ***Stock Based Compensation***

We adopted the "Share-Based Payment" guidance in 2005 using the modified prospective approach. Prior to our adoption of the guidance, we did not record tax benefits of deductions resulting from the exercise of stock options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2012, the Company recognized cash outflows of approximately \$23,000 related to a tax provision from stock-based compensation. In 2011, the Company recognized cash inflows of approximately \$67,000 related to a tax benefit from stock-based compensation.

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

Our computation of expected volatility is based on a combination of historical and market-based implied volatility. The volatility rate was derived by examining historical stock price behavior and assessing management's expectations of stock price behavior during the term of the option. The term of the options was derived based on the "simplified method" calculation. We are using the "simplified method" calculation, which is derived by averaging the vesting term with the contractual terms.

If any of the assumptions used in the Black-Scholes model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. We believe the accounting for stock-based compensation is a critical accounting policy because it requires the use of complex judgment in its application.

### ***Segment Reporting***

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

## Table of Contents

### Results of Operations

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

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

	2012	2011	2010
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenue	79.7	59.7	33.7
Sales and marketing	6.5	7.7	8.6
Customer service	4.1	4.1	3.9
Technical operations	2.2	2.8	3.0
Development	5.4	5.6	7.6
General and administrative	14.3	16.6	23.7
Depreciation	2.7	2.7	2.4
Amortization of intangible assets other than goodwill	—	0.8	1.0
Impairment of goodwill, long-lived assets and other assets	—	2.4	0.8
Total costs and expenses	<u>114.9</u>	<u>102.4</u>	<u>84.7</u>
Operating (loss) income	(14.9)	(2.4)	15.3
Interest expense (income) and other, net	(0.4)	0.3	(0.1)
(Loss) income before income taxes	(14.5)	(2.7)	15.4
Provision (benefit) for income taxes	9.8	0.6	6.3
Net (loss) income	<u>(24.3)%</u>	<u>(3.3)%</u>	<u>9.1%</u>

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

(in thousands)	2012	2011	2010
<b>Net (loss) income</b>	<b>\$ (14,989)</b>	<b>\$ (1,611)</b>	<b>\$ 3,704</b>
Interest expense	59	102	207
Income tax (benefit) provision	6,047	305	2,558
Depreciation	1,673	1,320	962
Impairments	—	1,145	308
Amortization of intangible assets	13	370	421
Non-cash currency translation adjustments	(124)	337	(269)
Stock-based compensation	813	906	1,510
Non-repetitive property possession	(151)	(247)	—
<b>Adjusted EBITDA<sup>(1)</sup></b>	<b><u>\$ (6,659)</u></b>	<b><u>\$ 2,627</u></b>	<b><u>\$ 9,401</u></b>

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

- Adjusted EBITDA does not reflect the cash capital expenditures during the measurement period,
- Adjusted EBITDA does not reflect any changes in working capital requirements during the measurement period,
- Adjusted EBITDA does not reflect the cash tax payments during the measurement period, and
- Adjusted EBITDA may be calculated differently by other companies in our industry, thus limiting its value as a comparative measure.

## Table of Contents

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

### Key Metric—Average Paying Subscribers

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

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

	Year Ended December 31,		
	2012	2011	2010
<b>Average Paying Subscribers</b>			
Jewish Networks	85,292	89,429	90,452
Christian Networks	146,267	71,311	26,366
Other Networks	27,685	35,595	44,813
<b>Total Average Paying Subscribers</b>	<b>259,244</b>	<b>196,335</b>	<b>161,631</b>

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

Average paying subscribers for the Jewish Networks segment decreased 1.1% to 89,429 for the year ended December 31, 2011 compared to 90,452 in 2010. Average paying subscribers for the Christian Networks segment increased 170.5% to 71,311 for the year ended December 31, 2011 compared to 26,366 in 2010, reflecting increased direct marketing investment within this segment. Average paying subscribers for the Other Networks segment decreased 20.6% to 35,595 for the year ended December 31, 2011 compared to 44,813 in 2010. This decrease can be primarily attributed to a reduction in inefficient marketing spend in prior and current periods.

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

### Segment Reclassification

During the first quarter of 2012, the Company's management modified the internal reporting of its operating segments to: (1) Jewish Networks, which consists of JDate.com, JDate.co.uk, JDate.fr, JDate.co.il, Cupid.co.il, and their respective co-branded Web sites; (2) Christian Networks, which now consists of ChristianMingle.com, ChristianMingle.co.uk, ChristianMingle.com.au, Believe.com, ChristianCards.net, DailyBibleVerse.com and Faith.com; (3) Other Networks, which consists of Spark.com and related other general market Web sites as well as other properties which are primarily composed of sites targeted towards various religious, ethnic, geographic and special interest groups; and (4) Offline & Other Businesses, which consists of revenue generated from offline activities and HurryDate events and subscriptions. The Company believes the new segments provide investors with greater transparency into the performance of the business.

---

## [Table of Contents](#)

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

#### **Revenue**

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

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

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

#### **Costs and Expenses**

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

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

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

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

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

*Development.* Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses increased 23.5% to \$3.3 million for the year ended December 31, 2012, compared to \$2.7 million in 2011. The increase can be attributed to higher compensation expense, consulting fees, placement fees and software licensing fees. The Company increased its development team headcount in 2012, which led to higher compensation and placement fees expense. The higher consulting and software licensing fees reflect management's focus on introducing new products to market.

## Table of Contents

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

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

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

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

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

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

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

### **Year Ended December 31, 2011 Compared to Year Ended December 31, 2010**

#### **Revenue**

Substantially all of our revenue is derived from subscription fees. Approximately 5.0% and 5.2% of our revenue for the years ended December 31, 2011 and 2010, respectively, were generated through offline social and travel events, and advertising revenue. Revenue is presented net of credits and credit card chargebacks. Our subscriptions are offered in durations of varying length (typically, one, three, six and twelve months). Plans with durations longer than one month are available at discounted monthly rates. Following their initial terms, most subscriptions renew automatically until subscribers terminate them.

Revenue for the year ended December 31, 2011 increased 18.7% to \$48.5 million from \$40.9 million in 2010. The revenue increase can be primarily attributed to a 170.1% increase in Christian Networks revenue.

Revenue for the Jewish Networks segment decreased 1.4% to \$27.1 million for the year ended December 31, 2011, compared to \$27.4 million in 2010. The lower Jewish Networks revenue reflects a 0.5% decrease in average revenue per user ("ARPU"), and a 1.1% decrease in average paying subscribers. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related prices. Revenue for our Christian Networks segment increased 170.1% to \$15.7 million for the year ended December 31, 2011, compared to \$5.8 million in 2010. The higher Christian Networks revenue reflects a 170.5% increase in average paying subscribers, driven by a 290.8% increase in direct marketing investments. Revenue for the Other Networks segment decreased 25.6% to \$4.9 million for the year ended December 31, 2011, compared to \$6.6 million in 2010. The decrease in Other Networks revenue is due to a 20.6% decrease in average paying subscribers, reflecting the elimination of inefficient online and offline marketing expenses. Revenue from our Offline and Other Businesses segment decreased 19.9% to \$772,000 for the year ended December 31, 2011 compared to \$1.0 million in 2010. The decrease in revenue is attributable to fewer hosted events in 2011.

## [Table of Contents](#)

### **Costs and Expenses**

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses increased 43.3% to \$49.6 million for the year ended December 31, 2011, compared to \$34.6 million in 2010. The increase is primarily attributable to a \$15.2 million increase in cost of revenue.

*Cost of Revenue.* Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue increased 110.6% to \$29.0 million for the year ended December 31, 2011, compared to \$13.7 million in 2010. This increase can be primarily attributed to higher Christian Networks direct marketing expenses. Direct marketing expenses for the Christian Networks segment increased 290.8% to \$19.4 million for the year ended December 31, 2011, compared to \$5.0 million in 2010. The higher direct marketing expense reflects management's focus on increasing market share and cultivating greater brand awareness for ChristianMingle through a combination of online and offline marketing channels.

*Sales and Marketing.* Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses increased 6.5% to \$3.7 million for the year ended December 31, 2011, compared to \$3.5 million in 2010. The increase can be primarily attributed to growth in compensation expense and consulting fees. The Company increased its marketing team headcount in 2011, which led to higher compensation expense.

*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 23.7% to \$2.0 million for the year ended December 31, 2011, compared to \$1.6 million in 2010. The expense increase is primarily attributed to higher compensation costs, reflecting increased support for our growing Christian Networks segment.

*Technical Operations.* Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses increased 11.0% to \$1.4 million for the year ended December 31, 2011, compared to \$1.2 million in 2010. The increase reflects higher compensation expense associated with additional personnel.

*Development.* Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses decreased by 12.4% to \$2.7 million for the year ended December 31, 2011, compared to \$3.1 million in 2010. The decreased costs reflect lower salary expense due to personnel changes and higher capitalized salaries associated with software development.

*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 decreased 17.5% to \$8.1 million for the year ended December 31, 2011, compared to \$9.8 million in 2010. In 2010, the Company incurred approximately \$1.0 million in non-recurring charges associated with our Special Committee process, litigation related to the Special Committee process and the transfer of certain assets out of our United Kingdom entity into two United States entities.

*Depreciation.* Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expense increased by 37.2% to \$1.3 million for the year ended December 31, 2011, compared to \$962,000 in 2010. Higher capitalized software which started in 2010 accounted for the increase in depreciation expenses.

*Amortization of Intangible Assets.* Amortization expenses consist primarily of amortization of intangible assets related to acquisitions, primarily LDSSingles and HurryDate. Amortization expense decreased 12.1% to \$370,000 for the year ended December 31, 2011, compared to \$421,000 in 2010. The decrease reflects the full amortization of MingleMatch and LDSSingles assets.

*Impairment of Long-lived Assets.* Impairment of long-lived assets primarily represents the write-down of investments in businesses and computer software. Long-lived assets impairment expense was \$1.1 million for the year ended December 31, 2011, compared to \$308,000 in 2010. In 2011, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value.

*Interest Expense (income) and Other, Net.* Interest expense (income) and other consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Interest expense (income) and other reflected a \$162,000 expense for the year ended December 31, 2011, compared to income of \$54,000 in 2010. The change is primarily due to non-cash foreign exchange rate fluctuations related to the intercompany loan with our Israel subsidiary, offset by a \$247,000 gain recorded for assets received from a legal judgment.

*Provision for Income Taxes.* Provision for income taxes for the year ended December 31, 2011 was \$306,000 compared to provision for income taxes of \$2.6 million for the year ended December 31, 2010. The 2011 provision for income taxes relates primarily to an increase in the deferred tax liability associated with our Israeli subsidiary's tax deductible goodwill amortization and partially offset by a net tax benefit recorded on losses incurred in the US. The 2010 provision for income taxes consists primarily of US federal and state income tax expense.

*Net (loss) Income and Net (loss) Income Per Share.* Net loss was \$1.6 million, or \$0.08 per share, for the year ended December 31, 2011, compared to net income of \$3.7 million or \$0.18 per share in 2010. The net loss in 2011 was primarily due to increases in Jewish and Christian Networks direct marketing investments.

## Table of Contents

### Quarterly Results of Operations

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

(in thousands)	Three Months Ended							
	Dec. 31, 2012	Sept. 30, 2012	June 30, 2012	March 31, 2012	Dec. 31, 2011	Sept. 30, 2011	June 30, 2011	March 31, 2011
<b>Consolidated Statement of Operations Data:</b>								
Revenue	\$ 16,271	\$ 15,871	\$ 15,046	\$ 14,555	\$ 12,861	\$ 12,677	\$ 11,995	\$ 10,960
Cost of revenue	13,491	12,901	10,976	11,848	8,420	7,373	7,347	5,815
Sales and marketing	1,015	1,020	983	973	1,062	923	837	900
Customer service	647	652	622	613	539	531	449	461
Technical operations	296	362	355	350	281	336	336	414
Development	797	859	844	846	643	643	679	745
General and administrative	2,237	2,260	2,052	2,238	1,071	2,435	2,199	2,363
Depreciation	431	426	413	403	343	341	346	290
Amortization	—	—	—	13	89	90	93	98
Impairment of goodwill and other assets	—	—	—	—	1,100	45	—	—
Total cost and expenses	18,914	18,480	16,245	17,284	13,548	12,717	12,286	11,086
Loss from operations	(2,643)	(2,609)	(1,199)	(2,729)	(687)	(40)	(291)	(126)
Interest expense (income) and other, net	(188)	(36)	113	(127)	144	120	(45)	(57)
Loss before income taxes	(2,455)	(2,573)	(1,312)	(2,602)	(831)	(160)	(246)	(69)
Provision (benefit) for income taxes	8,083	(836)	(311)	(889)	277	78	(165)	115
Net loss	<u>\$ (10,538)</u>	<u>\$ (1,737)</u>	<u>\$ (1,001)</u>	<u>\$ (1,713)</u>	<u>\$ (1,108)</u>	<u>\$ (238)</u>	<u>\$ (81)</u>	<u>\$ (184)</u>
Basic and diluted net loss per share <sup>1</sup>	\$ (0.51)	\$ (0.08)	\$ (0.05)	\$ (0.08)	\$ (0.05)	\$ (0.01)	\$ (0.00)	\$ (0.01)
Shares used in computation of basic and diluted net loss per share <sup>1</sup>	20,816	20,699	20,625	20,596	20,595	20,595	20,589	20,587
Average paying subscribers <sup>2</sup>	279,260	266,075	250,934	240,706	212,398	205,650	189,650	177,641

[Table of Contents](#)

	Three Months Ended							
	Dec 31, 2012	Sep 30, 2012	Jun 30, 2012	Mar 31, 2012	Dec 31, 2011	Sep 30, 2011	Jun 30, 2011	Mar 31, 2011
Costs and expenses include stock-based compensation as follows:								
Cost of revenue	\$ 2	\$ 2	\$ 2	\$ 2	\$ 2	\$ 2	\$ 2	\$ 2
Sales and marketing	21	17	18	20	15	17	14	34
Customer service	1	—	1	—	—	—	—	—
Technical operations	29	29	30	30	31	30	27	31
Development	11	10	10	11	10	10	10	12
General and administrative	150	138	138	141	125	124	226	182

- (1) For information regarding the computation of per share amounts, refer to Note 1 of our consolidated financial statements.
- (2) Represents average paying subscribers calculated as the sum of the average paying subscribers for each month in the period, divided by the three. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two.

---

## [Table of Contents](#)

### **Liquidity and Capital Resources**

As of December 31, 2012, we had cash and cash equivalents of \$10.5 million. We have historically financed our operations with internally generated funds.

Net cash used in operations was \$3.9 million for the year ended December 31, 2012 compared to net cash provided by operations of \$3.1 million for the same period in 2011. The increase in Christian Networks direct marketing accounted for the majority of change in net cash used in operations.

Net cash used in investing activities was \$1.8 million for 2012 compared to \$1.9 million for the same period in 2011. Capital expenditures for 2012 and 2011 were \$2.1 million and \$1.6 million, respectively, representing the purchase of computer hardware and capitalized software. In 2012, the Company received \$520,000 in connection with the sale of certain real property received in 2011 as a result of a legal judgment in favor of the Company.

Net cash provided by financing activities was \$1.0 million for the year ended December 31, 2012 compared to \$88,000 for 2011. Cash provided by financing activities in 2012 was primarily related to proceeds from issuance of stock of \$1.1 million compared to \$21,000 for the same period in 2011.

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 February 14, 2014.

On May 7, 2012, the parties executed a Fourth Amendment to the Credit Agreement (the "Amendment"). The Amendment, among other things, changes the per annum interest rate under the Credit Agreement. Pursuant to the Amendment, 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%. Under the Amendment, the Company pays a 0.25% per annum commitment fee on all funds not utilized under the facility, measured on a daily basis.

The Amendment removed the requirement that the Company maintain a certain consolidated leverage ratio and consolidated fixed charge coverage ratio. The Amendment also updated the financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA, Jewish Networks minimum contribution, minimum consolidated net liquidity and minimum consolidated revenue during different periods. The Amendment permits the Company to repurchase or redeem equity interests or issue dividends of up to \$4.5 million during the term of the Credit Agreement. The Credit Agreement also contains 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.

The Company was compliant with the Credit Agreement's customary affirmative and negative covenants, as of December 31, 2012.

As of December 31, 2012, there was no outstanding amount under the Credit Agreement. In connection with the original Credit Agreement and the first four amendments thereto, the Company paid deferred financing costs of approximately \$446,000 and \$105,000, respectively. Costs associated with both the original Credit Agreement and the first four amendments thereto were included in prepaid expenses and other, and deposits and other assets. The deferred financing costs are amortized to interest expense in the Consolidated Statements of Operations and Comprehensive (Loss) Income over the full term of the Credit Agreement. Amortization expense for the deferred financing costs for the years ended December 31, 2012 and December 31, 2011 were \$25,000 and \$56,000, respectively.

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

## Table of Contents

### Contractual Obligations

The following table describes our contractual commitments and obligations as of December 31, 2012 (in thousands):

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
Operating leases	\$ 773	\$ 824	\$ 326	\$ —	\$1,923
Other commitments and obligations	355	710	—	—	1,065
Total contractual obligations	<u>\$ 1,128</u>	<u>\$ 1,534</u>	<u>\$ 326</u>	<u>\$ —</u>	<u>\$2,988</u>

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

### Off-Balance Sheet Arrangements

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

### Recent Accounting Developments

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance on presentation of comprehensive income. The new guidance eliminates the option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity is required to present either a continuous statement of net income and other comprehensive income or in two separate but consecutive statements. In addition, in December 2011, the FASB issued an amendment to an existing accounting standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The new guidance is effective for the Company beginning January 1, 2012 and the impact is limited to the presentation of financial statements.

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We adopted this standard in the first quarter of 2012 and the adoption did not have a material impact on our financial statements.

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

Not applicable for a smaller reporting company.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the "Exchange Act." Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2012.

---

[Table of Contents](#)

**Internal Control Over Financial Reporting**

***(a) Management's annual report on internal controls over financial reporting***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on criteria established in the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, the Company's management concluded that its internal control over financial reporting was effective as of December 31, 2012.

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

***(b) Attestation Report***

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's attestation in this annual report.

***(c) Changes in internal control over financial reporting***

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

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

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

**ITEM 11. EXECUTIVE COMPENSATION.**

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

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

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

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

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

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

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

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

- (a)(1) All financial statements and schedules have been omitted because they are either not applicable, not required or the information required has been disclosed in the Consolidated Financial Statements and related Notes to Consolidated Financial Statements beginning on page F-1, or otherwise included in this Form 10-K.
- (a)(3) Exhibits

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
3.1	Amended and Restated Certificate of Incorporation of Spark Networks, Inc. (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 7, 2010).
3.2	Certificate of Designation of Series C Preferred Stock (incorporated by reference to Exhibit 3.1(A) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
3.3(a)	Amended and Restated Bylaws effective June 7, 2010 of Spark Networks, Inc. (incorporated by reference to Exhibit 3.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 7, 2010).
3.3(b)	Amendment No. 1 to Amended and Restated Bylaws effective August 10, 2011 (incorporated by reference to Exhibit 3.1(a) of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 11, 2011).
4.1	Rights Plan Dated July 9, 2007 Between Spark Networks, Inc. and The Bank of New York (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.1(a)	Lease dated September 1, 2000 between Arden Realty Limited Partnership and the Registrant regarding 8383 Wilshire Boulevard (incorporated by reference to exhibit 10.1 of MatchNet, Inc.'s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004).
10.1(b)	First Amendment to Lease, dated September 5, 2000 (incorporated by reference to exhibit 10.1(a) of MatchNet, Inc.'s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004).
10.1(c)	Second Amendment to Lease, dated January 16, 2003 (incorporated by reference to exhibit 10.1(b) of MatchNet, Inc.'s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004).
10.1(d)	Third Amendment to Lease, dated October 30, 2003 (incorporated by reference to exhibit 10.1(c) of MatchNet, Inc.'s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004).
10.1(e)	Fourth Amendment to Lease, dated May 14, 2004 (incorporated by reference to exhibit 10.1(d) of MatchNet, Inc.'s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004).
10.1(f)	Fifth Amendment to Lease, dated January 31, 2006 (incorporated by reference to Exhibit 10.1(e) of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).
10.1(g)	Sixth Amendment to Lease, dated February 6, 2007 (incorporated by reference to Exhibit 10.1(f) of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007).
10.1(h)	Seventh Amendment to Lease, dated November 27, 2007 (incorporated by reference to Exhibit 10.1(g) of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2008).
10.1(i)	Eighth Amendment to Lease, dated April 22, 2011 (incorporated by reference to Exhibit 10.1(i) of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2012).

## Table of Contents

- 10.2(a) 2004 Share Option Scheme (incorporated by reference to Exhibit 10.2 of the Registrant's Registration Statement on Form S-1 (File No. 333-123228) filed with the Securities and Exchange Commission on March 10, 2005).
- 10.2(b) Amendment to the 2004 Share Option Scheme, dated November 25, 2008 (incorporated by reference to Exhibit d(6) to the Registrant's Schedule TO filed with the Securities and Exchange Commission on December 2, 2008).
- 10.2(c) Amendment to the 2004 Option Scheme (incorporated by reference to Exhibit 10.3 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.3 Form of Option Agreement for 2004 Share Option Scheme (incorporated by reference to Exhibit 10.2(a) of the Registrant's Registration Statement on Form S-1/A (File No. 333-123228) filed with the Securities and Exchange Commission on November 14, 2005).
- 10.4(a) 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.4(b) Amendment No. 1 to the 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 6, 2009).
- 10.5 Form of Stock Option Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(A) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.6 Form of Restricted Stock Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(B) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.7 Form of Restricted Stock Unit Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(C) of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.8 Standstill Agreement entered into by the Registrant and Great Hill Equity Partners II on December 1, 2005 (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 7, 2005).
- 10.9 Consent to Assignment and Assumption of Standstill Agreement with Great Hill Equity Partners II (incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.10 Form of Indemnification Agreement with Officers and Directors (incorporated by reference to Exhibit 10.4 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.10(a) Schedule of Officers and Directors who entered into Indemnification Agreements (incorporated by reference to Exhibit 10.12(a) of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2008).
- 10.11(a) Executive Employment Agreement, dated February 12, 2007, between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 13, 2007).
- 10.11(b) Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
- 10.11(c) Amendment No. 2, dated December 29, 2010, to Executive Employment Agreement between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 3, 2011).
- 10.12 Separation Agreement and Release dated April 11, 2011 between Spark Networks, Inc. and Adam S. Berger (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 12, 2011).
- 10.13(a) Executive Employment Agreement, dated April 11, 2011, between the Registrant and Gregory R. Liberman (incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 12, 2011).

## Table of Contents

- 10.13(b) Amendment No. 1 to Employment Agreement dated December 20, 2012 between Spark Networks, Inc. and Gregory R. Liberman (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 21, 2012).
- 10.14(a) Employment Agreement dated July 2, 2007 between Spark Networks plc and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.5 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
- 10.14(b) Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.3 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
- 10.15(a) Executive Employment Agreement dated May 16, 2007 between Spark Networks plc and Gregory J. Franchina (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 21, 2007).
- 10.15(b) Amendment No. 1, dated December 30, 2008, to Executive Employment Agreement between the Registrant and Gregory J. Franchina (incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
- 10.16(a) Executive Employment Agreement executed November 27, 2007 between Spark Networks, Inc. and Brett Zane (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 27, 2007).
- 10.16(b) Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Brett Zane (incorporated by reference to Exhibit 10.5 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
- 10.17(a) Credit Agreement dated February 14, 2008 among Spark Networks Limited, Spark Networks, Inc. and Bank of America, N.A. (incorporated by reference to Exhibit 10.01 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 19, 2008).
- 10.17(b) First Amendment to Credit Agreement dated as of September 29, 2009 among Spark Networks Limited, Spark Networks, Inc., Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 29, 2009).
- 10.17(c) Second Amendment to Credit Agreement dated as of February 7, 2011 among Spark Networks Limited, Spark Networks, Inc., Spark Networks USA, LLC, Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 8, 2011).
- 10.17(d) Third Amendment to Credit Agreement dated as of May 11, 2011 among Spark Networks USA, LLC, Spark Networks, Inc., and Bank of America, N.A. (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2011).
- 10.17(e) Fourth Amendment to Credit Agreement dated as of May 7, 2012 among Spark Networks, Inc., Spark Networks USA, LLC, the Subsidiary Guarantors, Bank of America, N.A. (as Administrative Agent), and the other lenders thereto (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 11, 2012).
- 10.18 Lease between the Irvine Company LLC and Spark Networks USA, LLC dated as of February 1, 2013.
- 21.1 List of subsidiaries (incorporated by reference to Exhibit 21.1 of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 25, 2011).
- 23.1 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm
- 31.1 Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\* Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

## Table of Contents

101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

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

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



INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
<b>Spark Networks, Inc.</b>	
<a href="#">Report of Ernst &amp; Young LLP, Independent Registered Public Accounting Firm</a>	47
<a href="#">Consolidated Balance Sheets at December 31, 2012 and December 31, 2011</a>	48
<a href="#">Consolidated Statements of Operations and Comprehensive (Loss) Income for the years ended December 31, 2012, 2011 and 2010</a>	49
<a href="#">Consolidated Statements of Stockholders' Equity for the years ended December 31, 2012, 2011 and 2010</a>	50
<a href="#">Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010</a>	51
<a href="#">Notes to Consolidated Financial Statements</a>	52

---

[Table of Contents](#)

**Report of Independent Registered Public Accounting Firm**

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

We have audited the accompanying consolidated balance sheets of Spark Networks, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive (loss) income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spark Networks, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

Los Angeles, California  
March 8, 2013

[Table of Contents](#)

**SPARK NETWORKS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(in thousands, except stock data)**

	December 31,	
	2012	2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 10,458	\$ 15,106
Restricted cash	1,232	958
Accounts receivable, net of allowance of \$0 and \$1	1,510	1,146
Deferred tax asset—current	8	44
Prepaid expenses and other	861	1,164
Total current assets	14,069	18,418
Property and equipment, net	3,133	2,839
Goodwill	8,861	8,683
Intangible assets, net	2,143	1,900
Deferred tax asset—non-current	5	5,641
Deposits and other assets	153	455
Total assets	<u>\$ 28,364</u>	<u>\$ 37,936</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,093	\$ 952
Accrued liabilities	5,339	4,046
Deferred revenue	8,128	5,723
Deferred tax liability—current portion	257	203
Total current liabilities	14,817	10,924
Deferred tax liability	1,413	1,219
Other liabilities—non-current	588	1,141
Total liabilities	16,818	13,284
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Authorized capital stock consists of 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 and 100,000,000 shares of Common Stock, \$0.001 par value, with 20,945,364 and 20,594,670 shares of Common Stock issued and outstanding at December 31, 2012 and 2011, respectively, at stated values of:	21	21
Additional paid-in-capital	54,857	53,014
Accumulated other comprehensive income	712	672
Accumulated deficit	(44,044)	(29,055)
Total stockholders' equity	11,546	24,652
Total liabilities and stockholders' equity	<u>\$ 28,364</u>	<u>\$ 37,936</u>

See accompanying notes.



**SPARK NETWORKS, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**(in thousands)**

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>		<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>					
BALANCE, December 31, 2009	20,582	\$ 21	\$ 48,813	\$ 638	\$ (31,148)	\$ 18,324	
Issuance of common stock upon exercise of stock options	5	—	17	—	—	17	
Excess tax benefits from stock-based compensation	—	—	1,680	—	—	1,680	
Foreign currency translation adjustments, net of tax	—	—	—	135	—	135	
Stock-based compensation	—	—	1,510	—	—	1,510	
Net income	—	—	—	—	3,704	3,704	
BALANCE, December 31, 2010	20,587	\$ 21	\$ 52,020	\$ 773	\$ (27,444)	\$ 25,370	
Issuance of common stock upon exercise of stock options	8	—	21	—	—	21	
Excess tax benefits from stock-based compensation	—	—	67	—	—	67	
Foreign currency translation adjustments, net of tax	—	—	—	(101)	—	(101)	
Stock-based compensation	—	—	906	—	—	906	
Net loss	—	—	—	—	(1,611)	(1,611)	
BALANCE, December 31, 2011	20,595	\$ 21	\$ 53,014	\$ 672	\$ (29,055)	\$ 24,652	
Issuance of common stock upon exercise of stock options	350	—	1,053	—	—	1,053	
Excess tax provisions from stock-based compensation	—	—	(23)	—	—	(23)	
Foreign currency translation adjustments, net of tax	—	—	—	40	—	40	
Stock-based compensation	—	—	813	—	—	813	
Net loss	—	—	—	—	(14,989)	(14,989)	
BALANCE, December 31, 2012	20,945	\$ 21	\$ 54,857	\$ 712	\$ (44,044)	\$ 11,546	

See accompanying notes.

**SPARK NETWORKS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Years Ended December 31,		
	2012	2011	2010
<b>Cash flows from operating activities:</b>			
Net (loss) income	\$(14,989)	\$ (1,611)	\$ 3,704
Adjustments to reconcile net (loss) income to cash (used in) provided by operating activities:			
Depreciation and amortization	1,686	1,690	1,383
Impairment of goodwill, long-lived assets and other assets	—	1,145	308
Stock-based compensation	813	906	1,510
Non-current taxes payable and other	(534)	96	46
Foreign exchange (gain) loss on intercompany loan	(124)	337	(269)
Income from asset received from legal judgment	(151)	(247)	—
Excess tax (provisions) benefits from stock-based compensation	23	(67)	(1,680)
Deferred taxes	5,897	(96)	1,843
Changes in operating assets and liabilities:			
Accounts receivable, net	(364)	(299)	(163)
Restricted cash	(274)	38	(315)
Prepaid expenses and other assets	336	(128)	(31)
Accounts payable and accrued liabilities	1,414	(100)	(641)
Deferred revenue	2,405	1,392	87
Net cash (used in) provided by operating activities	<u>(3,862)</u>	<u>3,056</u>	<u>5,782</u>
<b>Cash flows from investing activities:</b>			
Sales of property and equipment	520	—	1,560
Purchases of property and equipment	(2,081)	(1,583)	(1,324)
Purchases of businesses and intangible assets	(255)	(356)	(37)
Net cash (used in) provided by investing activities	<u>(1,816)</u>	<u>(1,939)</u>	<u>199</u>
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of stock	1,053	21	17
Excess tax (provision) benefit from stock-based compensation	(23)	67	1,680
Net cash provided by financing activities	<u>1,030</u>	<u>88</u>	<u>1,697</u>
Net (decrease) increase in cash	(4,648)	1,205	7,678
Cash and cash equivalents at beginning of year	15,106	13,901	6,223
Cash and cash equivalents at end of year	<u>\$ 10,458</u>	<u>\$ 15,106</u>	<u>\$ 13,901</u>
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid for income taxes	\$ 45	\$ 192	\$ 874

See accompanying notes.

**SPARK NETWORKS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. The Company and Summary of Significant Accounting Policies**

**The Company**

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

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

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

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

**Principles of Consolidation**

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

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

The nature of the intercompany loan between the Company and its Israel subsidiary is classified as a loan which the Company expects to be settled. The foreign exchange gains and losses related to this loan are recorded as part of net (loss) income and excluded from accumulated other comprehensive income (loss). For the years ended December 31, 2012 and 2011, the Company recorded a foreign exchange gain of \$124,000 and a foreign exchange loss of \$337,000, respectively, related to the intercompany loan.

The results of the subsidiaries have been incorporated in the financial results of the consolidated entity since the date of acquisition.

**Revenue Recognition and Deferred Revenue**

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

## [Table of Contents](#)

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

### **Fair Value Measurement**

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

- Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2—Other inputs that are directly or indirectly observable in the marketplace.
- Level 3—Unobservable inputs which are supported by little or no market activity.

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

As of December 31, 2012 and 2011, the Company had financial assets that consisted of cash and cash equivalents, which were measured at fair value using quoted prices for identical assets in an active market (Level 1 fair value hierarchy) in accordance with the latest guidance.

### **Cash and Cash Equivalents**

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

### **Restricted Cash**

The Company's credit card processors regularly withhold deposits and maintain balances which the Company records as restricted cash. As of December 31, 2012 and 2011, the Company had \$1.2 million and \$1.0 million in restricted cash, respectively.

### **Accounts Receivable**

Accounts receivable is primarily composed of credit card payments for subscription fees, less amounts withheld and presented as restricted cash, pending collection from the credit card processors and to a much smaller extent, receivables for advertising sales. The Company reviews its accounts receivable from advertisers on a monthly basis to determine if an allowance is necessary. The allowance for doubtful accounts as of December 31, 2011 is \$1,000. An allowance was not necessary as of December 31, 2012.

### **Prepaid Advertising Expenses**

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

### **Web Site and Software Development Costs**

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

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

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Capitalized	\$ 1,641	\$1,250	\$1,100
Expensed	(1,186)	(850)	(504)
Impaired	—	(45)	(121)
Unamortized Balance	\$ 2,431	\$1,976	\$1,621

---

## [Table of Contents](#)

### **Property and Equipment**

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

### **Goodwill**

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired resulting from business acquisitions, specifically allocated to reporting units. The Company determines its reporting units and operating segments through the use of the management approach. The management approach considers the internal organizational structure used by the Company's chief operating decision maker for making operating decisions and assessing performance. Annually, the Company analyzes the fair value of each reporting unit to assess if the fair value exceeds the carrying value. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices or appraised values, depending on the nature of the assets. If fair value is below the carrying amount of the reporting unit, the Company assesses what the fair value of the reporting unit is and impairs the excess. The valuation of intangible assets incorporates significant unobservable inputs and requires estimates, including the amount and timing of future cash flows. As of December 31, 2012 and 2011, the Company had unamortized goodwill of approximately \$8.9 million and \$8.7 million, respectively.

### **Intangible Assets**

Intangible assets resulting from the acquisitions of entities are recorded using the purchase method of accounting and estimated by management based on the fair value of assets received. Identifiable intangible assets are comprised mainly of domain names and acquired technologies. Domain names were determined to have indefinite useful lives, thus, they are not amortized. Intangible assets with finite useful lives are amortized using the straight-line method over their estimated useful lives.

In 2011, largely based on the valuation of domain names and capitalized software acquired from prior period acquisitions, the Company recorded an impairment charge of approximately \$1.1 million for intangible assets it deemed to not have substantial value. In 2012, an impairment charge was not necessary.

### **Impairment of Long-lived Assets**

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

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

For the years 2011 and 2010, the Company impaired approximately \$45,000 and \$121,000, respectively, of capitalized software development costs when management determined that a Web-based product failed to perform to Company standards. In 2012, an impairment charge was not necessary.

---

## **Table of Contents**

### **Income Taxes**

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

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

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

### **Cost of Revenue**

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Direct marketing costs are expensed in the period incurred and primarily represent online marketing, including payments to search engines and affiliates, and offline marketing, including radio, billboards, television and print advertising. For the years ended December 31, 2012, 2011 and 2010, the Company incurred direct marketing costs amounting to approximately \$45.7 million, \$25.7 million and \$10.7 million, respectively.

### **Sales and Marketing**

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

### **Customer Service**

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

### **Technical Operations**

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

### **Development**

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

### **General and Administrative**

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

## [Table of Contents](#)

### Stock-based Compensation

The Company adopted the “Stock-Based Payment” guidance in 2005 using the modified prospective approach and accordingly periods prior to 2005 have not been restated to reflect the impact of the guidance.

Prior to our adoption of the guidance, the Company did not record tax benefits of deductions resulting from the exercise of share options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2012, the Company recognized cash outflows of approximately \$23,000 related to a tax provision from the stock-based compensation. In 2011, the Company recognized cash inflows of approximately \$67,000 related to a tax benefit from the stock-based compensation.

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

	2012	2011	2010
Expected life in years	4.27-5.77	4.56	4.56
Dividend per share	—	—	—
Volatility	35.0%	35.0-45.0%	40.0-45.0%
Risk-free interest rate	1.0-1.75%	1.4-3.0%	1.0-3.0%

The Company used historical and empirical data to assess different forfeiture rates for three different groups of employees. The Company must reassess forfeiture rates when deemed necessary and it must calibrate actual forfeiture behavior to what has already been recorded. For 2012, 2011 and 2010, there were three groups of employees whose behavior was significantly different from each other. Therefore, the Company estimated different forfeiture rates for each group.

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

Due to the re-pricing of most options in 2009, the Company is using the “simplified method” calculation, to determine the term of the options. The “simplified method” calculation derives the term by averaging the vesting term with the contractual terms. Option awards to date have generally vested and been expensed in equal annual installments over a four-year period.

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

### Comprehensive (Loss) Income

Comprehensive (loss) income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For the Company, comprehensive (loss) income consists of its reported net income (loss) and foreign currency translation adjustments, net of tax, for the years 2012, 2011 and 2010.

## [Table of Contents](#)

### Fair Value of Financial Instruments

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

### Net (Loss) Income Per Share

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

	For the Year Ended December 31		
	(in thousands except per share amounts)		
	2012	2011	2010
<b>Net (Loss) Income Per Common Share—Basic and Diluted</b>			
Net (loss) income applicable to common stock	\$ (14,989)	\$ (1,611)	\$ 3,704
Weighted average shares outstanding- basic	20,781	20,591	20,586
Weighted average shares outstanding- diluted	20,781	20,591	20,590
<b>Net (Loss) Income Per Share—Basic and Diluted</b>	<b>\$ (0.72)</b>	<b>\$ (0.08)</b>	<b>\$ 0.18</b>

Options to purchase 3.8 million, 3.5 million and 3.3 million shares for fiscal years 2012, 2011 and 2010, respectively, were not included in the computation of diluted net (loss) income per share because the options were anti-dilutive.

### Use of Estimates

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

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

### Recent Accounting Developments

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance on presentation of comprehensive income. The new guidance eliminates the option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity is required to present either a continuous statement of net income and other comprehensive income or in two separate but consecutive statements. In addition, in December 2011, the FASB issued an amendment to an existing accounting standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The new guidance was effective for the Company beginning January 1, 2012 and the impact was limited to the presentation of the consolidated financial statements.

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard was effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company adopted this standard in the first quarter of 2012 and the adoption did not have a material impact on our financial statements.

[Table of Contents](#)

**2. Income Taxes**

	Year Ended December 31,		
	2012	2011	2010
(Loss) income before income taxes: (in thousands)			
U.S.	\$ (8,984)	\$ (619)	\$ 5,986
Foreign	42	(687)	276
	<u>\$ (8,942)</u>	<u>\$ (1,306)</u>	<u>\$ 6,262</u>
Income tax expense: (in thousands)			
<b>Current</b>			
Federal	\$ (22)	\$ (326)	\$ 1,920
State	143	638	518
Foreign	45	69	2
	<u>166</u>	<u>381</u>	<u>2,440</u>
<b>Deferred</b>			
Federal	(3,121)	50	60
State	95	(160)	35
Foreign	5	477	115
	<u>(3,021)</u>	<u>367</u>	<u>210</u>
Change in valuation allowance	8,902	(443)	(92)
Total income tax expense	<u>\$ 6,047</u>	<u>\$ 305</u>	<u>\$ 2,558</u>
Reconciliation of effective income tax rate:			
(Benefit) provision on earnings at federal statutory rate	(34.0)%	(34.0)%	34.0%
State tax (benefit) provision, net of federal (benefit) provision	(1.1)	6.0	4.8
Nondeductible expenses	—	0.3	0.3
Tax reserves	2.2	(1.3)	0.6
Change in effective tax rates	1.7	18.6	0.3
Foreign tax rate differential	0.3	9.6	(4.3)
Valuation allowance	100.0	(8.9)	3.0
Write down of deferred tax asset	—	34.1	—
Other	(1.1)	(1.1)	2.2
Total provision for income taxes	<u>68.0%</u>	<u>23.3%</u>	<u>40.9%</u>

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

## Table of Contents

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

(in thousands)	Year Ended December 31,		
	2012	2011	2010
<b>Deferred income tax assets</b>			
Net operating loss carry-forward	\$ 4,506	\$ 782	\$ 940
Depreciation and amortization	1,358	1,655	1,383
Compensation accruals	2,236	2,590	2,234
Credits	899	913	905
Other	573	496	534
Total before valuation allowance	9,572	6,436	5,996
Less: Valuation allowance	(9,568)	(649)	(805)
Total deferred income tax asset	4	5,787	5,191
<b>Deferred income tax liabilities</b>			
Foreign Intangible assets	(1,401)	(1,205)	(814)
Other	(260)	(319)	(277)
Total deferred income tax liabilities	(1,661)	(1,524)	(1,091)
Total net deferred income tax (liabilities) assets	<u>\$ (1,657)</u>	<u>\$ 4,263</u>	<u>\$ 4,100</u>

As of December 31, 2012, the Company has a valuation allowance against its U.S. and foreign deferred tax assets of approximately \$9.6 million. Companies are required to assess whether a valuation allowance should be recorded against their deferred tax assets ("DTAs") based on the consideration of all available evidence, using a "more likely than not" realization standard. The four sources of taxable income that must be considered in determining whether DTAs will be realized are, (1) future reversals of existing taxable temporary differences (i.e. offset of gross deferred tax assets against gross deferred tax liabilities); (2) taxable income in prior carryback years, if carryback is permitted under the tax law; (3) tax planning strategies and (4) future taxable income exclusive of reversing temporary differences and carryforwards.

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. The Company has evaluated its DTAs each reporting period, including an assessment of its cumulative income or loss over the prior three-year period, to determine if a valuation allowance was required. A significant negative factor in the assessment was the Company's three-year cumulative loss history as of December 31, 2012.

After a review of the four sources of taxable income described above and in view of its three-year cumulative loss, the Company was not able to conclude that it is more likely than not that its DTAs will be realized. As a result, the Company recorded an additional valuation allowance on its DTAs, with a corresponding charge to the income tax provision, of approximately \$8.9 million as of December 31, 2012.

At December 31, 2012, the Company has gross net operating loss carry-forwards for income tax purposes of approximately \$18.6 million and \$38.4 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2025 for federal purposes and 2018 for state purposes. Under Section 382 of the Internal Revenue Code, the utilization of the net operating loss carry-forwards may be limited based on changes in the percentage ownership of the Company.

At December 31, 2012, the Company also has net operating loss carryovers for Israeli tax purposes of approximately \$2.9 million which do not expire.

At December 31, 2012, the Company has federal income tax credit carry-forwards for income tax purposes of approximately \$900,000 available to reduce future federal income tax.

The Company recognizes excess tax benefits associated with the exercise of stock options directly to stockholders' equity only when realized. Accordingly, deferred tax assets are not recognized for net operating losses resulting from excess tax benefits. As of December 31, 2012, deferred tax assets do not include approximately \$4.8 million of these excess tax benefits from employee stock option exercises that are a component of the Company's net operating loss carry forwards. Accordingly, additional paid-in-capital will be increased up to an additional \$4.8 million if and when such excess tax benefits are realized. During 2012, approximately \$23,000 related to a net excess tax provision was realized.

The Company adopted the accounting guidance for uncertain tax positions on January 1, 2007. The guidance clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The guidance also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Upon adoption, the Company recognized no adjustment in the amount of unrecognized tax positions. As of the date of adoption, the Company had no unrecognized tax positions.

## Table of Contents

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

(in thousands)	2012	2011	2010
Balance at beginning of year	\$ 975	\$ 839	\$839
Additions for tax positions of prior years	250	463	—
Reductions for tax positions of prior years	—	(327)	—
Balance at end of year	<u>\$1,225</u>	<u>\$ 975</u>	<u>\$839</u>

Included in the unrecognized tax benefits of \$1.2 million at December 31, 2012 was \$941,000 of tax, if recognized, would reduce our annual effective tax rate.

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

As of December 31, 2012 and 2011, the Company had recorded a \$216,000 and \$165,000 accrual for interest and penalties on unrecognized tax benefits, respectively. Interest expense (income) of \$51,000, (\$31,000) and \$58,000 were recognized in the years ended December 31, 2012, 2011 and 2010, respectively. The Company does not expect any significant decreases to its unrecognized tax benefit within the next 12 months.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years before 2009; state and local income tax examinations before 2008; and foreign income tax examinations before 2008. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carry forward amount.

### 3. Property and Equipment

Property and equipment consists of the following:

(in thousands)	As of December 31,	
	2012	2011
Computer equipment	\$ 2,083	\$ 1,868
Computer software	6,060	4,831
Furniture, fixtures and equipment	694	592
Leasehold improvements	667	691
	<u>9,504</u>	<u>7,982</u>
Less: Accumulated depreciation	<u>(6,371)</u>	<u>(5,143)</u>
	<u>\$ 3,133</u>	<u>\$ 2,839</u>

Depreciation expense, for the years ended December 31, 2012 and 2011, was \$1.7 million and \$1.3 million, respectively, and is calculated on the straight-line basis over three years.

[Table of Contents](#)

**4. Goodwill and Other Intangible Assets**

**Goodwill**

Goodwill as of December 31, 2012 and 2011 is related to the purchase of Pointmatch in January 2004, MingleMatch, Inc. in May 2005, and LDSSingles in May 2006. Jewish Networks, Christian Networks, and Other Networks are the reporting units with goodwill balances. Jewish Networks goodwill balance at December 31, 2012 and 2011 was \$6.9 million and \$6.8 million, respectively. Christian Networks goodwill balance at December 31, 2012 and 2011 was \$1.7 million. Other Networks goodwill balance at December 31, 2012 and 2011 was \$232,000. The following table shows the activity and balances related to goodwill from January 1, 2011 to December 31, 2012:

(in thousands)	Gross Goodwill	Accumulated Impairments	Net Goodwill
Balance at January 1, 2011	\$ 22,890	\$ (13,734)	\$ 9,156
Foreign currency translation adjustments	(473) <sup>(1)</sup>	—	(473) <sup>(1)</sup>
Balance at December 31, 2011	22,417	(13,734)	8,683
Foreign currency translation adjustments	178 <sup>(1)</sup>	—	178 <sup>(1)</sup>
Balance at December 31, 2012	\$ 22,595	\$ (13,734)	\$ 8,861

<sup>(1)</sup> Foreign currency translation adjustments related to the Jewish Networks reporting unit.

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

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

**Other Intangibles**

Finite-lived intangible assets consist of purchased technologies and are amortized over the expected periods of benefits (five years). Indefinite-lived intangible asset, consist of purchased domain names and are not amortized. Other intangible assets consist of the following:

(in thousands)	As of December 31, 2012		As of December 31, 2011	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Purchased technologies	\$ 1,200	\$ (1,200)	\$ 1,200	\$ (1,187)
Domain names	2,143	—	1,887	—
	<u>\$ 3,343</u>	<u>\$ (1,200)</u>	<u>\$ 3,087</u>	<u>\$ (1,187)</u>

Amortization expense for finite-lived intangible assets for the years ended December 31, 2012 and 2011 was \$13,000 and \$370,000, respectively. In 2011, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value based upon the expected future cash flows generated from the businesses associated with these assets, resulting in an impairment charge of approximately \$1.1 million.

## [Table of Contents](#)

### 5. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31,	
	2012	2011
	(in thousands)	
Advertising	\$1,789	\$1,452
Compensation	1,882	1,905
Other	1,668	689
Total	<u>\$5,339</u>	<u>\$4,046</u>

### 6. Income on Possession of Assets

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

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

### 7. Revolving Credit Facility

The Company and its wholly-owned subsidiary, Spark Networks USA, LLC have a \$15.0 million revolving credit facility with Bank of America, which was entered into on February 14, 2008 with subsequent amendments (the "Credit Agreement"). The Credit Agreement matures on February 14, 2014.

On May 7, 2012, the parties executed a Fourth Amendment to the Credit Agreement (the "Amendment"). The Amendment, among other things, changes the per annum interest rate under the Credit Agreement. Pursuant to the Amendment, 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%. Under the Amendment, the Company pays a 0.25% per annum commitment fee on all funds not utilized under the facility, measured on a daily basis.

The Amendment removed the requirement that the Company maintain a certain consolidated leverage ratio and consolidated fixed charge coverage ratio. The Amendment also updated the financial covenants regarding the requirement to maintain a minimum consolidated adjusted EBITDA, Jewish Networks minimum contribution, minimum consolidated net liquidity and minimum consolidated revenue during different periods. The Amendment permits the Company to repurchase or redeem equity interests or issue dividends of up to \$4.5 million during the term of the Credit Agreement. The Credit Agreement also contains 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.

The Company was compliant with the Credit Agreement's customary affirmative and negative covenants, as of December 31, 2012.

As of December 31, 2012, there was no outstanding amount under the Credit Agreement. In connection with the original Credit Agreement and the first four amendments thereto, the Company paid deferred financing costs of approximately \$446,000 and \$105,000, respectively. Costs associated with both the original Credit Agreement and the first four amendments thereto were included in prepaid expenses and other, and deposits and other assets. The deferred financing costs are amortized to interest expense in the Consolidated Statements of Operations and Comprehensive (Loss) Income over the full term of the Credit Agreement. Amortization expense for the deferred financing costs for the years ended December 31, 2012 and 2011 were \$25,000 and \$56,000, respectively.

## [Table of Contents](#)

### 8. Stockholders' Equity

#### Employee Stock Option Plans

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

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

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

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

As of December 31, 2012, total unrecognized compensation cost related to non-vested stock options was \$2.3 million. This cost is expected to be recognized over a weighted-average period of 3 years. The following table describes option activity for the years ended December 31, 2012, 2011 and 2010:

	Years Ended December 31,		
	2012	2011	2010
Granted, weighted average fair value per share	\$ 2.02	\$ 1.02	\$1.07
Exercised, weighted average intrinsic value per share	\$ 2.89	\$ 0.32	\$0.46
Aggregate intrinsic value of options outstanding and exercisable (in thousands)	\$12,614	\$1,571	\$ 371

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

	Number of Shares	Weighted Average Price per Share
Outstanding at December 31, 2010	3,364	\$ 3.12
Granted	700	3.19
Exercised	(8)	2.96
Expired	(10)	3.30
Forfeited	(463)	2.99
Outstanding at December 31, 2011	3,583	3.14
Granted	665	7.36
Exercised	(350)	3.00
Expired	(12)	4.38
Forfeited	(57)	3.15
Outstanding at December 31, 2012	<u>3,829</u>	<u>\$ 3.88</u>

**Option Range Summary**  
As of December 31, 2012

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price
\$3.18 - \$10.00	1,507	7	\$ 5.27	550	5	\$ 3.88
\$3.00	2,202	4	\$ 3.00	2,071	4	\$ 3.00
\$2.18 - \$2.99	120	3	\$ 2.54	99	3	\$ 2.57
	<u>3,829</u>	5	\$ 3.88	<u>2,720</u>	5	\$ 3.16

**Re-Pricing of Employees Options**

In 2009, the Company offered to re-price options for certain employees. These employees could surrender their existing options in exchange for a like number of options with a new grant date, a lower exercise price, a lower number of vested options and a modified vesting schedule. The exchange of options was treated as a synthetic re-pricing, which includes a cancellation and replacement of equity instruments. The incremental expense was approximately \$1.0 million and is being recognized over the four year vesting term of the newly issued options. The incremental expenses recognized for the years ended December 31, 2012, 2011 and 2010 were \$172,000, \$172,000 and \$339,000, respectively.

**Stockholder Rights Plan**

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

**9. Employee Benefit Plan**

The Company has a defined contribution plan under Section 401(k) of the Internal Revenue Code covering all full-time employees, and providing for matching contributions by the Company, as defined in the plan. Participants in the plan may direct the investment of their personal accounts to a choice of mutual funds consisting of various portfolios of stocks, bonds or cash instruments. Contributions made by the Company to the plan for the years ended December 31, 2012, 2011 and 2010 were approximately \$349,000, \$338,000 and \$333,000, respectively.

**10. Segment Information**

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for

## Table of Contents

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

(in thousands)	Years Ended December 31		
	2012	2011	2010
<b>Revenue</b>			
Jewish Networks	\$26,034	\$27,054	\$27,440
Christian Networks	31,574	15,742	5,828
Other Networks	3,765	4,925	6,619
Offline and Other Businesses	370	772	964
Total Revenue	<u>\$61,743</u>	<u>\$48,493</u>	<u>\$40,851</u>
<b>Direct Marketing Expenses</b>			
Jewish Networks	\$ 3,111	\$ 3,389	\$ 2,321
Christian Networks	41,400	19,356	4,953
Other Networks	977	2,467	2,921
Offline and Other Businesses	165	512	535
Total Direct Marketing Expenses	<u>\$45,653</u>	<u>\$25,724</u>	<u>\$10,730</u>
Unallocated Operating Expense	25,270	23,913	23,913
<b>Operating (Loss) Income</b>	<u><b>\$ (9,180)</b></u>	<u><b>\$ (1,144)</b></u>	<u><b>\$ 6,208</b></u>

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.

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

(in thousands)	Years Ended December 31		
	2012	2011	2010
<b>Revenue</b>			
United States	\$57,734	\$44,358	\$36,849
Israel	4,009	4,135	4,002
Total Revenue	<u>\$61,743</u>	<u>\$48,493</u>	<u>\$40,851</u>
		<b>As of December 31,</b>	
		2012	2011
<b>Long-Lived Assets</b>			
United States		\$3,144	\$3,117
Israel		142	177
<b>Total Long-Lived Assets</b>		<u><b>\$3,286</b></u>	<u><b>\$3,294</b></u>

## [Table of Contents](#)

### 11. Commitments and Contingencies

#### Operating Leases

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

<u>Year Ending (amounts in thousands)</u>	
2013	\$ 773
2014	584
2015	240
2016	204
2017	122
Total	<u>\$1,923</u>

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

The Company recognized rent expense under operating leases of \$1.0 million, \$1.0 million and \$1.3 million for the years ended December 31, 2012, 2011 and 2010, respectively.

#### Other Commitments and Obligations

The Company has other non-cancelable commitments and obligations consisting of contracts with software licensing, communications and marketing service providers. These amounts totaled \$355,000 for less than one year and \$710,000 between one and three years. Contracts with other service providers are for terms less than one year.

<u>Year Ending (amounts in thousands)</u>	
2013	\$ 355
2014	355
2015	355
Total	<u>\$1,065</u>

#### 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

---

## **Table of Contents**

the dismissal of certain other claims. On April 19, 2012, the matter was remanded back to the District Court. On September 4, 2012, Spark Networks filed its Answer to the Complaint. By written order dated August 30, 2012, the Court set the action for trial on February 24, 2014.

### *B.E. Technology, L.L.C. v. Spark Networks, Inc.*

On September 22, 2012, B.E. Technology, L.L.C. commenced a lawsuit against Spark Networks, Inc. in the Western District of Tennessee, B.E. Technology, L.L.C. v. Spark Networks, Inc., Civil Action No. 2:12-cv-02832-cgc, for alleged infringement of U.S. Patent No. 6,628,314. The patent is entitled "Computer Interface Method And Apparatus With Targeted Advertising." The Complaint alleges that "Spark Networks has infringed at least claim 11 of the '314 patent by using a method of providing demographically targeted advertising," and seeks damages and an injunction. On December 31, 2012, Spark filed an Answer to the Complaint denying that the '314 patent was infringed by Spark and alleging, among other things, that the patent was invalid. On January 7, 2013, B.E. Technology served its Initial Infringement Contentions asserting that Spark had infringed claims 11, 12, 13, 15, 18, 19 and 20. The Company has made a motion to transfer the case to California.

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

On October 16, 2012, Kristina Kirby, Christopher Wagner and Jamie Carper (collectively referred to as "Plaintiffs"), on behalf of themselves and all other similarly situated, filed a putative class action Complaint in the Superior Court for the State of California, County of Los Angeles (Case No. BC493892) alleging claims against Spark Networks USA, LLC for violations of California Business & Professions Code section 17529.5. Plaintiffs allege that certain e-mail communications advertising Web sites of Spark Networks USA, LLC and received by Plaintiffs violate a California statute prohibiting false and deceptive e-mail communications (namely, California Business & Professions Code section 17529.5). Plaintiffs generally allege that they seek damages in excess of \$25,000.

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

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

## **12. Related Party Transactions**

In 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, an owner of more than 5% of the Company's stock, has informed the Company that it has an ownership position in Latisys-Irvine, Inc. The Company paid \$189,000 for services rendered by Latisys-Irvine, Inc. in 2012.

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

## **13. Quarterly Results of Operations**

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

## Table of Contents

(in thousands, except per share amount)	Three Months Ended							
	Dec. 31, 2012	Sept. 30, 2012	June 30, 2012	March 31, 2012	Dec. 31, 2011	Sept. 30, 2011	June 30, 2011	March 31, 2011
<b>Consolidated Statement of Operations Data:</b>								
Revenue	\$ 16,271	\$ 15,871	\$ 15,046	\$ 14,555	\$ 12,861	\$ 12,677	\$ 11,995	\$ 10,960
Cost of revenue	13,491	12,901	10,976	11,848	8,420	7,373	7,347	5,815
Sales and marketing	1,015	1,020	983	973	1,062	923	837	900
Customer service	647	652	622	613	539	531	449	461
Technical operations	296	362	355	350	281	336	336	414
Development	797	859	844	846	643	643	679	745
General and administrative	2,237	2,260	2,052	2,238	1,071	2,435	2,199	2,363
Depreciation	431	426	413	403	343	341	346	290
Amortization	—	—	—	13	89	90	93	98
Impairment of goodwill and other assets	—	—	—	—	1,100	45	—	—
Total cost and expenses	18,914	18,480	16,245	17,284	13,548	12,717	12,286	11,086
Loss from operations	(2,643)	(2,609)	(1,199)	(2,729)	(687)	(40)	(291)	(126)
Interest expense (income) and other, net	(188)	(36)	113	(127)	144	120	(45)	(57)
Loss before income taxes	(2,455)	(2,573)	(1,312)	(2,602)	(831)	(160)	(246)	(69)
Provision (benefit) for income taxes	8,083	(836)	(311)	(889)	277	78	(165)	115
Net loss	<u>\$ (10,538)</u>	<u>\$ (1,737)</u>	<u>\$ (1,001)</u>	<u>\$ (1,713)</u>	<u>\$ (1,108)</u>	<u>\$ (238)</u>	<u>\$ (81)</u>	<u>\$ (184)</u>
Net loss per share—basic and diluted	\$ (0.51)	\$ (0.08)	\$ (0.05)	\$ (0.08)	\$ (0.05)	\$ (0.01)	\$ (0.00)	\$ (0.01)
Shares used in computation of basic and diluted net loss per share	20,816	20,699	20,625	20,596	20,595	20,595	20,589	20,587

### 14. Subsequent Events (unaudited)

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

Subsequent to the balance sheet date, on February 1, 2013 the Company entered into a new office space lease for approximately 16,000 square feet of office space in Los Angeles, California. The current office space lease in Beverly Hills, California expires on July 31, 2013 and the Company will relocate the corporate, administrative, technology and development personnel, to the new office space prior to its expiration.

LEASE  
BETWEEN  
THE IRVINE COMPANY LLC  
AND  
SPARK NETWORKS USA, LLC

**LEASE**

THIS LEASE is made as of the 1<sup>st</sup> day of February, 2013, by and between **THE IRVINE COMPANY LLC**, a Delaware limited liability company, hereafter called "**Landlord**," and **SPARK NETWORKS USA, LLC**, a Delaware limited liability company, hereafter called "**Tenant**."

**ARTICLE 1. BASIC LEASE PROVISIONS**

Each reference in this Lease to the "**Basic Lease Provisions**" shall mean and refer to the following collective terms, the application of which shall be governed by the provisions in the remaining Articles of this Lease.

1. **Tenant's Trade Name:** N/A
2. **Premises:** Suite No. 600  
**Address of Building:** 11150 Santa Monica Blvd., Los Angeles, CA 90025  
**Project Description:** Westwood Gateway II  
(The Premises are more particularly described in Section 2.1).
3. **Use of Premises:** General office and any other ancillary uses consistent with the character of the Building and Project and for no other use.
4. **Commencement Date:** September 1, 2013, subject to Commencement Date Delays.
5. **Lease Term:** 62 months, plus such additional days as may be required to cause this Lease to expire on the final day of the calendar month.
6. **Basic Rent:**

<u>Months of Term or Period</u>	<u>Monthly Rate Per Rentable Square Foot</u>	<u>Monthly Basic Rent (rounded to the nearest dollar)</u>
1 to 12	\$2.75	\$43,117.00
13 to 24	\$2.87	\$44,999.00
25 to 36	\$3.00	\$47,037.00
37 to 48	\$3.14	\$49,232.00
49 to 62	\$3.28	\$51,427.00

Notwithstanding the above schedule of Basic Rent to the contrary, Tenant shall be entitled to an abatement of 6 full calendar months of Basic Rent in the aggregate amount of \$258,702.00 (i.e. \$43,117.00 per month) (the "**Abated Basic Rent**") for the first 6 full calendar months of the Term (the "**Abatement Period**"); provided, however, such abatement of Basic Rent shall be suspended during any period of a monetary or material non-monetary Default (as defined in Section 14.1 below). In the event this Lease terminates as a result of a Default by Tenant at any time during the initial Term, all unamortized Abated Basic Rent shall immediately become due and payable. The payment by Tenant of the Abated Basic Rent during the occurrence of a Default shall not limit or affect any of Landlord's other rights, pursuant to this Lease or at law or in equity. Only Basic Rent shall be abated during the Abatement Period and all other additional rent and other costs and charges specified in this Lease shall remain as due and payable pursuant to the provisions of this Lease.

7. **Property Tax Base:** The Property Taxes per rentable square foot incurred by Landlord and attributable to the twelve month period ending June 30, 2014 (the "**Base Year**").  
**Project Cost Base:** The Project Costs per rentable square foot incurred by Landlord and attributable to the Base Year.  
**Expense Recovery Period:** Every twelve month period during the Term (or portion thereof during the first and last Lease years) ending June 30.
8. **Floor Area of Premises:** approximately 15,679 rentable square feet  
**Floor Area of Building:** approximately 227,046 rentable square feet
9. **Security Deposit:** \$56,570.00
10. **Broker(s):** Irvine Realty Company ("**Landlord's Broker**") and Cresa Partners/Los Angeles ("**Tenant's Broker**")
11. **Parking:** 78 parking passes in accordance with the provisions set forth in **Exhibit F** to this Lease.

12. **Address for Payments and Notices:**

**LANDLORD**

Payment Address:

THE IRVINE COMPANY LLC  
P.O. Box #846532  
Los Angeles, CA 90084-6532

Notice Address:

The Irvine Company LLC  
11100 Santa Monica Boulevard, Suite 100  
Los Angeles, CA, 90025  
Attn: Property Manager

with a copy of notices to:

THE IRVINE COMPANY LLC  
550 Newport Center Drive  
Newport Beach, CA 92660  
Attn: Senior Vice President, Property Operations  
Irvine Office Properties

**TENANT**

**(prior to Commencement Date)**

SPARK NETWORKS USA, LLC  
8383 Wilshire Boulevard, Suite 800  
Beverly Hills, CA 90211  
Attn: Josh Kreinberg, General Counsel

**(on and after Commencement Date)**

SPARK NETWORKS USA, LLC  
11150 Santa Monica Blvd., Suite 600  
Los Angeles, CA 90025  
Attn: Josh Kreinberg, General Counsel

13. **List of Lease Exhibits** (all exhibits, riders and addenda attached to this Lease are hereby incorporated into and made a part of this Lease):

Exhibit A	Description of Premises
Exhibit B	Operating Expenses
Exhibit C	Utilities and Services
Exhibit D	Tenant's Insurance
Exhibit E	Rules and Regulations
Exhibit F	Parking
Exhibit G	Additional Provisions
Exhibit H	Janitorial Specifications
Exhibit X	Work Letter

## ARTICLE 2. PREMISES

**2.1. LEASED PREMISES.** Landlord leases to Tenant and Tenant leases from Landlord the premises shown in **Exhibit A** (the “**Premises**”), containing approximately the floor area set forth in Item 8 of the Basic Lease Provisions (the “**Floor Area**”). The Premises are located in the building identified in Item 2 of the Basic Lease Provisions (the “**Building**”), which is a portion of the project described in Item 2 (the “**Project**”). Landlord and Tenant stipulate and agree that the Floor Area of Premises set forth in Item 8 of the Basic Lease Provisions is correct. The Premises shall include the non-exclusive right of Tenant to use and have access to the janitorial closets and electrical and telephone rooms on the floor(s) of the Building which contains the Premises as well as the use of and access to the ceilings, walls and floors of the Premises for purposes of installing, maintaining, repairing and replacing wiring, conduit and cable serving Tenant’s equipment within the Premises, provided that any such installation, maintenance, repair and replacement shall be performed in accordance with, and subject to, the terms and provisions of this Lease. Tenant shall also have non-exclusive access to the Building risers and/or install additional risers for Tenant’s cabling subject to Landlord’s reasonable rules and regulations. Landlord shall also have the right to use of and access to all such areas consistent with the terms and provisions of this Lease for the purpose of performing its obligations and exercising its rights hereunder.

**2.2. ACCEPTANCE OF PREMISES.** Except as expressly provided in this Lease, Tenant acknowledges that neither Landlord nor any representative of Landlord has made any representation or warranty with respect to the Premises, the Building or the Project or the suitability or fitness of either for any purpose, except as set forth in this Lease. Tenant acknowledges that the flooring materials which may be installed within portions of the Premises located on the ground floor of the Building may be limited by the moisture content of the Building slab and underlying soils. The taking of possession or use of the Premises by Tenant for any purpose other than construction shall conclusively establish that the Premises and the Building were in satisfactory condition and in conformity with the provisions of this Lease in all respects. By taking possession of the Premises Tenant accepts the improvements in their existing condition, and waives any right or claim against Landlord arising out of the condition of the Premises. Nothing contained in this Section 2.2 shall affect the commencement of the Term or the obligation of Tenant to pay rent. Landlord shall diligently complete all punch list items of which it is notified as provided above.

**2.3 STORAGE SPACE.** In addition to the Premises, Tenant shall have the right, during the Term, to lease, on a month to month basis and subject to availability, up to three hundred sixty-five (365) square feet of storage space located in the Building at Landlord’s then current rate. As of the date of this Lease, the monthly storage space rental rate is \$2.00 per square feet. If Tenant desires to lease any such storage space, Tenant shall provide Landlord with written notice of the date on which it wishes to commence the lease of such storage space (not to be less than ten (10) business days in advance of such date), the amount of storage space square footage to be leased and the term of such lease (if other than month-to-month). Following Landlord’s receipt of such notice and provided such space is available, Landlord shall make such storage space available to Tenant as of the date specified therein.

## ARTICLE 3. TERM

**3.1. GENERAL.** The term of this Lease (“**Term**”) shall be for the period shown in Item 5 of the Basic Lease Provisions. The Term shall commence on the date as set forth in Item 4 of the Basic Lease Provisions subject to “**Commencement Date Delays**” as such term is defined in the Work Letter (“**Commencement Date**”). Within ten (10) business days following request by Landlord, the parties shall memorialize on a form provided by Landlord (the “**Commencement Memorandum**”) the actual Commencement Date and the expiration date (“**Expiration Date**”) of this Lease; should Tenant fail to execute and return the Commencement Memorandum to Landlord within 10 business days (or provide specific written objections thereto within that period), then Landlord’s determination of the Commencement and Expiration Dates as set forth in the Commencement Memorandum shall be conclusive. If Landlord and Tenant are unable to resolve any objections to a Commencement Date Memorandum between themselves, then the Commencement and Expiration Dates shall be resolved by judicial reference in accordance with Section 14.7(b) of this Lease.

**3.2. EARLY OCCUPANCY.** Following the full execution of this Lease, payment of all deposits due hereunder and delivery of proper evidence of insurance pursuant to **Exhibit D** hereof and provided that the Tenant Improvements described in the Work Letter attached as **Exhibit X** have been substantially completed and a Certificate of Occupancy or Temporary Certificate of Occupancy issued, if applicable, Tenant shall be permitted to occupy the Premises prior to the Commencement Date in order that it may commence its normal business operations therein. Tenant’s occupancy of the Premises prior to the Commencement Date shall be subject to all of the terms and obligations of this Lease, including the indemnity provisions herein, except that Tenant shall not be required to pay Basic Rent and Operating Expenses during that period.

## ARTICLE 4. RENT AND OPERATING EXPENSES

**4.1. BASIC RENT.** From and after the Commencement Date, Tenant shall pay to Landlord without deduction or offset, except as otherwise expressly provided in this Lease, the rental amount for the Premises in the total amount shown (including subsequent adjustments, if any) in Item 6 of the Basic Lease Provisions (the “**Basic Rent**”). If the Commencement Date is other than the first day of a calendar month, any rental adjustment shown in Item 6 shall be deemed to occur on the first day of the next calendar month following the specified monthly anniversary of the Commencement Date. The Basic Rent

shall be due and payable in advance commencing on the Commencement Date and continuing thereafter on the first day of each successive calendar month of the Term, as prorated for any partial month based on the actual number of days in such month. No demand, notice or invoice shall be required for the payment of Basic Rent. An installment of rent in the amount of 1 full month's Basic Rent at the initial rate specified in Item 6 of the Basic Lease Provisions shall be delivered to Landlord concurrently with Tenant's execution of this Lease and shall be applied against the Basic Rent first due hereunder; the next installment of Basic Rent shall be due on the first day of the eighth (8<sup>th</sup>) calendar month of the Term, which installment shall, if applicable, be appropriately prorated to reflect the amount prepaid for that calendar month.

**4.2. OPERATING EXPENSES.** Tenant shall pay Tenant's Share of Operating Expenses in accordance with **Exhibit B** of this Lease.

**4.3. SECURITY DEPOSIT.** Concurrently with Tenant's delivery of this Lease, Tenant shall deposit with Landlord the sum, if any, stated in Item 9 of the Basic Lease Provisions (the "**Security Deposit**"), to be held by Landlord as security for the full and faithful performance of Tenant's obligations under this Lease, to pay any rental sums, including without limitation such additional rent as may be owing under any provision hereof, and to maintain the Premises as required by Sections 7.1 and 15.2 or any other provision of this Lease. Upon any Default by Tenant, Landlord may apply all or part of the Security Deposit as full or partial compensation. If any portion of the Security Deposit is so applied, Tenant shall within 5 business days after written demand by Landlord deposit cash with Landlord in an amount sufficient to restore the Security Deposit to its original amount. Landlord shall not be required to keep this Security Deposit separate from its general funds, and Tenant shall not be entitled to interest on the Security Deposit. In no event may Tenant utilize all or any portion of the Security Deposit as a payment toward any rental sum due under this Lease. Any unapplied balance of the Security Deposit shall be returned to Tenant or, at Landlord's option, to the last assignee of Tenant's interest in this Lease within 30 days following the termination of this Lease and Tenant's vacation of the Premises. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, or any similar or successor laws now or hereafter in effect, in connection with Landlord's application of the Security Deposit to prospective rent that would have been payable by Tenant but for the early termination due to Tenant's Default (as defined herein).

## ARTICLE 5. USES

**5.1. USE.** Tenant shall use the Premises only for the purposes stated in Item 3 of the Basic Lease Provisions. The uses prohibited under this Lease shall include, without limitation, use of the Premises or a portion thereof for (i) offices of any agency or bureau of the United States or any state or political subdivision thereof; (ii) offices or agencies of any foreign governmental or political subdivision thereof; or (iii) schools, temporary employment agencies or other training facilities which are not ancillary to corporate, executive or professional office use. Tenant shall not do or permit anything to be done in or about the Premises which will in any way interfere with the rights or quiet enjoyment of other occupants of the Building or the Project, or use or allow the Premises to be used for any unlawful purpose, nor shall Tenant permit any nuisance or commit any waste in the Premises or the Project. Tenant shall not perform any work or conduct any business whatsoever in the Project other than inside the Premises. Tenant shall comply at its expense with all present and future laws, ordinances and requirements of all governmental authorities that pertain to Tenant or its use of the Premises.

**5.2. SIGNS.** Landlord, at Landlord's sole cost, shall affix and maintain a Building-standard sign (restricted solely to Tenant's name as set forth herein or such other name as Landlord may consent to in writing) adjacent to the entry door of the Premises, together with Tenant's prorata share of directory strip listings which may include Tenant's name and the names of any subtenants and assignees as set forth herein in the lobby directory of the Building. Any subsequent changes to that initial signage shall be at Tenant's sole expense. All signage shall conform to the criteria for signs established by Landlord and shall be ordered through Landlord. Except as provided in the foregoing, and except for Landlord's standard suite signage and lobby directory signage identifying Tenant's name and installed at a location reasonably designated by Landlord and the elevator sign, Tenant shall not place or allow to be placed any other sign, decoration or advertising matter of any kind that is visible from the exterior of the Premises. Any violating sign or decoration may be immediately removed by Landlord at Tenant's expense without notice and without the removal constituting a breach of this Lease or entitling Tenant to claim damages.

Provided that Tenant is then leasing the entire rentable area on any floor of the Building, Tenant shall be permitted to install identity signage in the elevator lobby of that floor. The dimensions, location, design, and manner of installation of such signage shall be subject to Landlord's reasonable prior written approval. Installation and maintenance of the elevator lobby sign shall be at Tenant's sole cost and expense. In the event Tenant ceases at any time to lease all of such floor and Landlord enters into a lease of all or any portion of such space to a third party that is not an Affiliate, then Tenant shall promptly remove such elevator lobby signage upon request by Landlord. Tenant shall also remove the signage upon the expiration or sooner termination of this Lease. Tenant agrees that it shall bear the cost of any resulting repairs to the Building that are reasonably necessary due to the removal. Repairs in connection with the removal of such elevator lobby shall be limited to repair of the stone wall, patching and approximately matching the existing paint and surface of the wall.

**5.3 HAZARDOUS MATERIALS.** Tenant shall not generate, handle, store or dispose of hazardous or toxic materials (as such materials may be identified in any federal, state or local law or regulation) in

the Premises or Project without the prior written consent of Landlord; provided that the foregoing shall not be deemed to proscribe the use by Tenant of customary office and cleaning supplies in normal quantities so long as such use comports with all applicable laws. To the best of Landlord's knowledge, as of the date of this Lease, there are no toxic or hazardous materials present in or under the Building or Project except for standard products typically used in the operation and maintenance of an office building.

## ARTICLE 6. LANDLORD SERVICES

**6.1. UTILITIES AND SERVICES.** Landlord shall furnish to the Premises those utilities and services described in **Exhibit C**, subject to the conditions and payment obligations and standards set forth in this Lease. Except as otherwise provided herein, Landlord shall not be liable for any failure to furnish any services or utilities when the failure is the result of any accident or other cause beyond Landlord's reasonable control, nor shall Landlord be liable for damages resulting from power surges or any breakdown in telecommunications facilities or services. Except as otherwise provided herein, Landlord's temporary inability to furnish any services or utilities shall not entitle Tenant to any damages, relieve Tenant of the obligation to pay rent or constitute a constructive or other eviction of Tenant, except that Landlord shall diligently attempt to restore the service or utility promptly. Tenant shall comply with all rules and regulations which Landlord may reasonably establish for the provision of services and utilities, and shall cooperate with all reasonable conservation practices established by Landlord. Landlord shall at all reasonable times have free access to all electrical and mechanical installations of Landlord.

Notwithstanding the foregoing, if as a result of the direct actions of Landlord, its employees, contractors or authorized agents, for more than three (3) consecutive business days following written notice to Landlord there is no elevator, HVAC or electricity services to all or a portion of the Premises, or such an interruption of other essential utilities and building services, such as fire protection or water, so that all or a portion of the Premises cannot be used by Tenant, then Tenant's Basic Rent (or an equitable portion of such Basic Rent to the extent that less than all of the Premises are affected) shall thereafter be abated until the Premises are again usable by Tenant; provided, however, that if Landlord is diligently pursuing the repair of such utilities or services and Landlord provides substitute services reasonably suitable for Tenant's purposes, as for example, bringing in portable air-conditioning equipment, then there shall not be an abatement of Basic Rent. The foregoing provisions shall be Tenant's sole recourse and remedy in the event of such an interruption of services, and shall not apply in case of the actions of parties other than Landlord, its employees, contractors or authorized agents, or in the case of damage to, or destruction of, the Premises (which shall be governed by the provisions of Article 11 of this Lease).

**6.2. OPERATION AND MAINTENANCE OF COMMON AREAS.** During the Term, Landlord shall operate and maintain all Common Areas within the Building and the Project in a manner Landlord may reasonably determine to be appropriate, but consistent with Landlord's operation and maintenance of its other properties in the Project and other Class A office properties in West Los Angeles market owned by Landlord. The term "**Common Areas**" shall mean all areas within the Building and other buildings in the Project which are not held for exclusive use by persons entitled to occupy space, and all other appurtenant areas and improvements provided by Landlord for the common use of Landlord and tenants and their respective employees and invitees, including without limitation parking areas and structures, driveways, sidewalks, landscaped and planted areas, hallways and interior stairwells not located within the premises of any tenant, common electrical rooms, entrances and lobbies, elevators, and restrooms not located within the premises of any tenant. Subject to the express provisions of this Lease (including, without limitation Articles 11 and 12 hereof), Tenant shall have access to the Premises, the Common Areas and the Building twenty-four (24) hours per day, three hundred sixty-five (365) days per year.

**6.3. USE OF COMMON AREAS.** The occupancy by Tenant of the Premises shall include the use of the Common Areas in common with Landlord and with all others for whose convenience and use the Common Areas may be provided by Landlord, subject, however, to compliance with Rules and Regulations described in Article 17 below and any other reasonable and non-discriminatory rules and regulations as are prescribed from time to time by Landlord. Landlord shall at all times during the Term have exclusive control of the Common Areas, and may restrain or permit any use or occupancy, except as otherwise provided in this Lease or in Landlord's rules and regulations. Tenant shall keep the Common Areas clear of any obstruction or unauthorized use related to Tenant's operations. Landlord may temporarily close any portion of the Common Areas for repairs, remodeling and/or alterations, to prevent a public dedication or the accrual of prescriptive rights, or for any other reasonable purpose. Landlord's temporary closure of any portion of the Common Areas for such purposes shall not deprive Tenant of reasonable access to the Premises.

**6.4. PARKING.** Parking shall be provided in accordance with the provisions set forth in **Exhibit F** to this Lease.

**6.5. CHANGES AND ADDITIONS BY LANDLORD.** Landlord reserves the right to make alterations or additions to the Building or the Project or to the attendant fixtures, equipment and Common Areas. No change shall entitle Tenant to any abatement of rent or other claim against Landlord, provided that the change does not deprive Tenant of reasonable access to or use of the Premises, the Building or the Common Areas for their uses permitted hereunder. No change by Landlord to the Common Areas shall: (i) materially impair access to and from the Premises from the parking areas, (ii) reduce the number or size of parking spaces allocated to Tenant pursuant to Item 11 of the Basic Lease Provisions, or (iii) materially increase Tenant's financial obligations under this Lease.

**6.6. EQUIPMENT LEASING AND FINANCING.** Notwithstanding any provision of this Lease to the contrary, Tenant may enter into leases for, and/or grant security interests in, Tenant's personal property and non-affixed trade fixtures in the Premises pursuant to commercially reasonable leases and/or security agreements, and Landlord shall (i) reasonably subordinate any Landlord lien rights it may have in and to such items to the interest of the lessors and lenders therein and, in the case of non-affixed trade fixtures (but not Tenant Improvements), waive any claim that the same are part of the Premises, and (ii) permit the lessors and lenders under any such leases and security agreements to remove the leased or encumbered property upon default by Tenant under such leases and security agreements, so long as (a) such removal work is performed on or prior to the expiration of this Lease, or within ten (10) days following an early termination of this Lease, or in the case of any lessors or lenders which have entered into a written agreement with Landlord, ten (10) days following written notice to such lessors or lenders of an early termination of this Lease (provided that the lessors and/or lenders agree to and shall pay to Landlord the rent which would otherwise have been payable by Tenant under this Lease, had this Lease not been so terminated, during the period following any such early termination utilized by such parties for such removal), (b) each such party repairs any damage to the Premises caused by such removal, (c) any such parties' right to enter the Premises shall be solely for the purpose of removing Tenant's personal property and no such party shall have any possessory right or interest whatsoever in the Premises or any portion thereof, and (d) each such lessor and/or lender provides a certificate of insurance reasonably acceptable to Landlord and agrees to indemnify, defend and hold Landlord and the Landlord Parties harmless from any and all claims arising from such party's entry onto the Premises.

## ARTICLE 7. REPAIRS AND MAINTENANCE

**7.1. TENANT'S MAINTENANCE AND REPAIR.** Subject to Articles 11 and 12 and except as otherwise set forth in this Lease, Tenant at its sole expense shall make all repairs necessary to keep the interior non-structural portions of the Premises and all improvements and fixtures therein in the condition as existed on the Commencement Date (or on any later date that the applicable improvements may have been installed), excepting ordinary wear and tear and casualty damage and destruction. Notwithstanding Section 7.2 below, Tenant's maintenance obligation shall include without limitation all appliances, interior glass, doors, door closures, hardware, fixtures, electrical, plumbing, fire extinguisher equipment and other equipment installed in the Premises and all Alterations constructed by Tenant pursuant to Section 7.3 below, together with any supplemental HVAC equipment servicing only the Premises. All repairs and other work performed by Tenant or its contractors shall be subject to the terms of Sections 7.3 and 7.4 below. Alternatively, should Landlord or its management agent agree to make a repair on behalf of Tenant and at Tenant's request, Tenant shall promptly reimburse Landlord as additional rent for all actual, reasonable, out-of-pocket costs incurred (including the standard supervision fee, not to exceed five percent (5%) of the cost of any work) within thirty (30) days after its receipt of an invoice therefor.

**7.2. LANDLORD'S MAINTENANCE AND REPAIR.** Subject to Section 7.1 and Article 10, Landlord shall service, operate, maintain, and repair all of the exterior areas located on the Project including the Common Areas, the Common Areas contained in the Building, the roof, foundations (and other structural portions of the Building), footings, floor and ceiling slabs, the exterior surfaces of the exterior walls of the Building (including exterior glass), curtain wall, mullions, window seals, columns, beams, shafts, stairs, stairwells, pavement, sidewalk, curbs, entryways, landscaping, men's and women's washrooms located in the Common Areas, and the structural systems serving the Building and the base building, electrical, plumbing, life safety sprinkler operations, any air conditioning, ventilating or heating ("HVAC") equipment which serves the Premises (exclusive, however, of supplemental HVAC equipment serving only the Premises), and mechanical systems (including elevators, if any, serving the Building). All such service maintenance and repair obligations of Landlord shall be performed in a manner consistent with Landlord's standing practices for similar buildings in the immediate vicinity of the Building. Landlord need not make any other improvements or repairs except as specifically required under this Lease, and nothing contained in this Section 7.2 shall limit Landlord's right to reimbursement from Tenant for maintenance, repair costs and replacement costs as provided elsewhere in this Lease. Tenant understands that it shall not make repairs at Landlord's expense or by rental offset. Except as provided in Sections 11.1 and 12.1 or Section 6.1 above, there shall be no abatement of rent and no liability of Landlord by reason of any injury to or interference with Tenant's business arising from the making of any repairs, alterations or improvements to any portion of the Building, including repairs to the Premises, nor shall any related activity by Landlord constitute an actual or constructive eviction; provided, however, that in making repairs, alterations or improvements, Landlord shall interfere as little as reasonably practicable with the conduct of Tenant's business in the Premises. Tenant hereby waives any and all rights under and benefits of subsection 1 of Section 1932, and Sections 1941 and 1942 of the California Civil Code, or any similar or successor laws now or hereafter in effect. All costs of any maintenance, repairs and replacements on the part of Landlord provided in this Section 7.2, other than the cost of repairs or replacements to the structural components of the roof, load-bearing walls, and the foundations and footings of the Building and all other structural elements of the Building which shall be Landlord's sole cost or other costs excluded from Operating Expenses pursuant to **Exhibit B**, shall be considered part of Operating Expenses.

**7.3. ALTERATIONS.** Except as otherwise provided in this Section, Tenant shall make no alterations, additions or improvements (collectively referred to as "Alterations") to the Premises without the prior written consent of Landlord; provided, however, Tenant may make cosmetic alterations to the Premises not requiring a permit without the Landlord's consent. To the extent required, Landlord's consent shall not be unreasonably withheld as long as the proposed Alterations do not affect the structural, electrical or mechanical components or systems of the Building, are not visible from the exterior of the Premises, do not change the basic floor plan of the Premises, and utilize only building

standard materials (“**Standard Improvements**”). Landlord may impose, as a condition to its consent, any requirements that Landlord in its discretion may deem reasonable or desirable provided that Landlord shall not require Alterations that cost less than Three Hundred Thousand Dollars (\$300,000.00) be covered by a lien and completion bond satisfactory to Landlord in its reasonable discretion. Without limiting the generality of the foregoing, Tenant shall use Landlord’s designated mechanical and electrical contractors (“**MEPs**”) for all Alterations work affecting the mechanical or electrical systems of the Building so long as the MEPs are reasonably available when needed by Tenant and the cost of Landlord’s MEPs is reasonable when considering their reputation, quality and expertise. Should Tenant perform any work that would necessitate any ancillary Building modification or other expenditure by Landlord, then Tenant shall, within thirty (30) days of Tenant’s receipt of a written invoice therefor, fund the cost thereof to Landlord. Tenant shall obtain all required permits for the work and shall perform the work in compliance with all applicable laws, regulations and ordinances, and Landlord shall be entitled to a supervision fee in the amount of three percent (3%) of the cost of the work either requiring a permit from the City of Los Angeles or affecting any mechanical, electrical, plumbing or HVAC systems, facilities or equipment located in or serving the Building. Any request for Landlord’s consent shall be made in writing and, to the extent appropriate, shall contain architectural plans describing the work in detail reasonably satisfactory to Landlord. Landlord may elect to cause its architect to review Tenant’s architectural plans, and the actual, reasonable, out-of-pocket cost of that review shall be reimbursed by Tenant within thirty (30) days of Tenant’s receipt of a written invoice therefor. Should the Alterations proposed by Tenant and consented to by Landlord change the floor plan of the Premises, then Tenant shall, at its expense, furnish Landlord with as-built drawings and CAD disks compatible with Landlord’s systems. Alterations shall be constructed in a good and workmanlike manner using materials of a quality reasonably approved by Landlord Unless Landlord otherwise agrees in writing, all Alterations affixed to the Premises, including without limitation all Tenant Improvements constructed pursuant to the Work Letter (except as otherwise provided in the Work Letter), but excluding moveable trade fixtures and furniture, shall become the property of Landlord and shall be surrendered with the Premises at the end of the Term, except that Landlord may, by notice to Tenant given at the time of Landlord’s consent to the alteration or improvement, require Tenant to remove by the Expiration Date, or sooner termination date of this Lease, all or any Alterations (including without limitation all telephone and data cabling) installed either by Tenant or by Landlord at Tenant’s request (collectively, the “**Required Removables**”). Tenant, at the time it requests approval for a proposed Alteration, may request in writing that Landlord advise Tenant whether the Alteration or any portion thereof, is a Required Removable. Within 10 days after receipt of Tenant’s request, Landlord shall advise Tenant in writing as to which portions of the subject Alterations are Required Removables. In connection with its removal of Required Removables, Tenant shall repair any damage to the Premises arising from that removal and shall restore the affected area to its pre-existing condition, reasonable wear and tear excepted. Notwithstanding the foregoing, Tenant shall not be required to remove at the end of the Lease Term any initial Tenant Improvements (as defined in **Exhibit X**) that are Building standard in Landlord’s sole discretion, except voice and/or data transmission cabling installed by or for Tenant.

**7.4. MECHANIC’S LIENS.** Tenant shall keep the Premises free from any liens arising out of any work performed, materials furnished, or obligations incurred by or for Tenant. Upon request by Landlord, Tenant shall promptly (but in no event later than ten (10) business days following such request) cause any such lien to be released by posting a bond in accordance with California Civil Code Section 8424 or any successor statute. In the event that Tenant shall not, within 30 days following the imposition of any lien, cause the lien to be released of record by payment or posting of a proper bond, Landlord shall have, in addition to all other available remedies, the right to cause the lien to be released by any means it deems proper, including payment of or defense against the claim giving rise to the lien. All expenses so incurred by Landlord, including Landlord’s attorneys’ fees, and any other damages incurred by Landlord arising out of such lien, shall be reimbursed by Tenant within thirty (30) days after written demand, together with interest from the date of payment by Landlord at the Interest Rate (as hereinafter defined) until paid. Tenant shall give Landlord no less than fifteen (15) days’ prior notice in writing before commencing construction of any kind on the Premises.

**7.5. ENTRY AND INSPECTION.** Landlord shall at all reasonable times, during reasonable business hours, upon at least forty-eight (48) hours written or oral notice to Tenant’s office manager (except in emergencies and providing janitorial services, when no notice shall be required), have the right to enter the Premises to inspect them, to supply services in accordance with this Lease, to protect the interests of Landlord in the Premises, to make repairs and renovations as reasonably deemed necessary by Landlord, and to submit the Premises to prospective or actual purchasers or encumbrance holders (or, during the final nine (9) months of the Term or when a Default exists, to prospective tenants), all without being deemed to have caused an eviction of Tenant and without abatement of rent except as provided elsewhere in this Lease. In exercising its right of entry pursuant to this Section 7.5, Landlord shall use its commercially reasonable efforts to not unreasonably interfere with Tenant’s use of, access to, or operation of its business within the Premises, Building, and Common Areas, and shall perform such work as expeditiously as reasonably possible. With respect to any work to be performed by Landlord within the Premises other than emergency work, daily janitorial or work requested by Tenant: (i) Landlord shall, to the extent reasonably practical, and subject to Tenant’s cooperating with respect to scheduling of such work, use its reasonable efforts to schedule such work with Tenant and cause such work to be performed during hours other than reasonable business hours, and (ii) Tenant shall have the right to postpone Landlord’s performance of such work for up to five (5) business days; provided that Tenant shall in all events be responsible for any increased costs occasioned by the foregoing scheduling and/or postponement of such work by Landlord. Landlord shall at all times have and retain a key which unlocks all of the doors in the Premises, excluding Tenant’s vaults, safes, and other secure areas, and Landlord shall have the right to use any and all means which Landlord may deem proper to open the doors in an

emergency in order to obtain entry to the Premises, and any entry to the Premises obtained by Landlord shall not under any circumstances be deemed to be a forcible or unlawful entry into, or a detainer of, the Premises, or any eviction of Tenant from the Premises. Landlord acknowledges and understands that certain operations of Tenant within the Premises may involve the use of confidential information or have sensitive equipment (such as the server room), and that such areas within the Premises may be designated by Tenant as secure areas. In recognition of such needs by Tenant, Landlord shall provide Tenant an opportunity to have an employee of Tenant accompany Landlord during any entry into the Premises by Landlord unless an employee of Tenant is not available to do so, and that in entering into any areas within the Premises which Tenant has designated to Landlord as secured areas, Landlord shall be accompanied, in any event, by an employee of Tenant, except in the case of an emergency.

## ARTICLE 8. INTENTIONALLY OMITTED

## ARTICLE 9. ASSIGNMENT AND SUBLETTING

### 9.1. RIGHTS OF PARTIES.

(a) Notwithstanding any provision of this Lease to the contrary, and except as to transfers expressly permitted without Landlord's consent pursuant to Section 9.1(e), Tenant will not, either voluntarily or by operation of law, assign, sublet, encumber, or otherwise transfer all or any part of Tenant's interest in this Lease, or permit the Premises to be occupied by anyone other than Tenant (each, a "**Transfer**"), without Landlord's prior written consent, which consent shall be granted or withheld within the time period set forth in Section 9.1(b), below, and shall not unreasonably be withheld in accordance with the provisions of Section 9.1(b). For purposes of this Lease, references to any subletting, sublease or variation thereof shall be deemed to apply not only to a sublease effected directly by Tenant, but also to a sub-subletting or an assignment of subtenancy by a subtenant at any level. Except as otherwise specifically provided in this Article 9, no Transfer (whether voluntary, involuntary or by operation of law) shall be valid or effective without Landlord's prior written consent and, at Landlord's election, such a Transfer shall be void and of no force and effect and any such attempted assignment, subletting or other transfer shall constitute a Default under this Lease following the cure period set forth in Section 14.1(b).

(b) If Tenant desires to assign, sublease or otherwise transfer an interest in this Lease or the Premises, it shall first notify Landlord of its desire and shall submit in writing to Landlord: (i) the name and address of the proposed assignee, subtenant or transferee; (ii) the nature of any proposed assignee's, subtenant's or transferee's business to be carried on in the Premises; (iii) the terms and provisions of any proposed assignment, sublease or other transfer, including a copy of the proposed assignment, sublease or transfer form; (iv) evidence that the proposed assignee, subtenant or transferee will comply with the requirements of **Exhibit D** hereto; (v) any other information reasonably requested by Landlord and reasonably related to the transfer and (vi) the fee described in Section 9.1(c). Landlord shall not unreasonably withhold its consent, provided that the parties agree that it shall be reasonable for Landlord to withhold its consent if: (1) the use of the Premises will not be consistent with the provisions of this Lease or with Landlord's commitment to other tenants of the Building and Project; (2) insurance requirements of the proposed assignee or subtenant may not be brought into conformity with Landlord's then current commercially reasonable leasing practice; (3) the proposed assignee, subtenant or transferee has not demonstrated to the reasonable satisfaction of Landlord that it is financially responsible, in light of the obligations to be incurred under such sublease or, in the case of an assignment, in light of the obligations remaining during the remainder of the Term, or has failed to submit to Landlord all reasonable information as requested by Landlord concerning the proposed assignee, subtenant or transferee, including, but not limited to, a reasonably current balance sheet of the proposed assignee, subtenant or transferee, statements of income or profit and loss of the proposed assignee, subtenant or transferee certified by its chief financial officer or independent accountant for the two-year period preceding the request for Landlord's consent, and/or a certification signed by the proposed assignee, subtenant or transferee that it has not been evicted from or been in arrears in rent at any other leased premises for the three (3) year period preceding the request for Landlord's consent; (4) the proposed assignee, subtenant or transferee is an existing tenant of the Building or Project, except that Landlord will not enforce this restriction if it does not have sufficient available space to accommodate the proposed transferee or a prospect with whom Landlord is actively negotiating within the preceding six (6) months as evidenced by written documentation or correspondence; (5) the proposed transferee is an SDN (as defined below); or (6) the proposed assignment, sublease or transfer will impose additional burdens or adverse tax effects on Landlord. If Landlord consents to the proposed transfer, Tenant may within one hundred eighty (180) days after the date of the consent effect the transfer upon the terms described in the information furnished to Landlord; provided that any material change in the terms shall be subject to Landlord's consent as set forth in this Section 9.1. Landlord shall approve or disapprove any requested transfer within fifteen (15) business days following delivery of Tenant's written request, the information set forth above, and the fee set forth below.

(c) Tenant shall pay to Landlord a fee equal to the greater of (i) Landlord's actual, reasonable, out-of-pocket costs related to such assignment, subletting or other transfer or (ii) Five Hundred Dollars (\$500.00), to process any request by Tenant for an assignment, subletting or other transfer under this Lease but not to exceed five thousand dollars (\$5,000.00). Tenant shall pay Landlord the sum of Five Hundred Dollars (\$500.00) concurrently with Tenant's request for consent to any assignment, subletting or other transfer, and Landlord shall have no obligation to consider such request unless accompanied by such payment. Tenant shall pay Landlord within thirty (30) days after demand any costs in excess of such payment to the extent Landlord's costs related to such request exceeds Five Hundred Dollars

(\$500.00 but not to exceed five thousand dollars (\$5,000.00)). Such fee is hereby acknowledged as a reasonable amount to reimburse Landlord for its costs of review and evaluation of a proposed transfer.

(d) In the event that Landlord approves the requested assignment, subletting or other transfer, Landlord shall be entitled to receive fifty percent (50%) (the "**Transfer Premium**") of any amounts paid by the assignee or subtenant, however described, in excess of the sum of (i) the Rent payable by Tenant hereunder, or in the case of a sublease of a portion of the Premises, in excess of the Rent reasonably allocable to such portion, plus (ii) Tenant's direct out-of-pocket costs which Tenant certifies to Landlord have been paid to provide occupancy related services to such assignee or subtenant of a nature commonly provided by landlords and/or sublandlords of similar space, (iii) any improvement allowance or other economic concessions (space planning allowance, moving expenses, and similar concessions) paid by Tenant to the transferee, (iv) brokerage commissions incurred by Tenant in connection with the transfer, (v) reasonable attorney's and Landlord transfer fees incurred by Tenant in connection with the transfer, (vi) any costs to buy-out or take over the prior lease of a transferee at other premises, and (vii) direct out of pocket costs of advertising for sublease or assignment which is the subject of the transfer. The portion of the Transfer Premium shall be payable to Landlord only after Tenant has recovered all of the foregoing costs from the amounts paid by the assignee or subtenant to Tenant, and the foregoing costs (other than the costs outlined in clause (i)) shall not be required to be amortized over the then remaining Term of this Lease or any shorter term of any sublease of the Premises or portion thereof. Notwithstanding the foregoing, Landlord shall not be entitled to any Transfer Premium in connection with the sale of Tenant's shares or Tenant's business or the fair market value of assets, fixtures, inventory, equipment, or furniture (other than this Lease and leasehold improvements) transferred to or for services rendered by Tenant to such transferee in connection with such transfer. The amounts due Landlord under this Section 9.1(d), shall be payable by Tenant within ten (10) business days of Tenant's receipt thereof. Landlord shall have the right to review or audit the books and records of Tenant, or have such books and records reviewed or audited by an outside accountant, to confirm any such direct out-of-pocket costs. In the event that such direct out-of-pocket costs claimed by Tenant are overstated by more than five percent (5%), Tenant shall reimburse Landlord for any of Landlord's costs related to such review or audit. At Landlord's request, a written agreement shall be entered into by and among Tenant, Landlord and the proposed assignee or subtenant confirming the requirements of this Section 9.1(d).

(e) The sale of all or substantially all of the assets of Tenant (other than bulk sales in the ordinary course of business), the merger or consolidation of Tenant, the sale of Tenant's capital stock (other than on a publicly traded exchange), or any other direct or indirect change of control of Tenant, including, without limitation, change of control of Tenant's parent company or a merger by Tenant or its parent company, shall be deemed a Transfer within the meaning and provisions of this Article. Notwithstanding the foregoing: (A) Landlord's consent shall not be required for the subletting of all or any portion of the Premises to any entity controlling, under common control with, or controlled by Tenant (an "**Affiliate**"), and (B) Landlord's consent shall not be required for the assignment of this Lease to an Affiliate, or as a result of a sale of all or substantially all of Tenant's or an Affiliate's assets, the sale of the capital stock of Tenant, or as the result of a merger by Tenant or a Tenant Affiliate with or into another entity or a reorganization of Tenant or an Affiliate (a "**Permitted Transfer**"), so long as (i) the net worth of the successor or reorganized entity after such merger is at least equal to Twenty Million Dollars (\$20,000,000.00), evidence of which, reasonably satisfactory to Landlord, shall be presented to Landlord prior to or within ten (10) days following such merger or reorganization or within ten (10) days following such Permitted Transfer, (ii) Tenant shall provide to Landlord, prior to such merger or reorganization or within ten (10) days following such Permitted Transfer, written notice of such merger or reorganization and such assignment documentation and other information as Landlord may require in connection therewith, and (iii) all of the terms and requirements of Sections 9.2 and 9.3 shall apply with respect to such assignment (but not of Section 9.1). No sublease or assignment permitted without Landlord's consent pursuant to this Section 9.1(e) shall be subject to the provisions of Sections 9.1(c) or (d).

**9.2. EFFECT OF TRANSFER.** No subletting or assignment, even with the consent of Landlord, shall relieve Tenant, or any successor-in-interest to Tenant hereunder, of its obligation to pay rent and to perform all its other obligations under this Lease. Each assignee, other than Landlord, shall be deemed to assume all obligations of Tenant under this Lease and shall be liable jointly and severally with Tenant for the payment of all rent, and for the due performance of all of Tenant's obligations, under this Lease. Such joint and several liability shall not be discharged or impaired by any subsequent modification or extension of this Lease. Consent by Landlord to one or more transfers shall not operate as a waiver or estoppel to the future enforcement by Landlord of its rights under this Lease.

**9.3. SUBLEASE REQUIREMENTS.** Any sublease, license, concession or other occupancy agreement entered into by Tenant shall be subordinate and subject to the provisions of this Lease, and if this Lease is terminated during the term of any such agreement, Landlord shall have the right to: (i) treat such agreement as cancelled and repossess the subject space by any lawful means, or (ii) require that such transferee attorn to and recognize Landlord as its landlord (or licensor, as applicable) under such agreement. Landlord shall not, by reason of such attornment or the collection of sublease rentals, be deemed liable to the subtenant for the performance of any of Tenant's obligations under the sublease. If Tenant is in Default (hereinafter defined), Landlord is irrevocably authorized to direct any transferee under any such agreement to make all payments under such agreement directly to Landlord (which Landlord shall apply towards Tenant's obligations under this Lease) until such Default is cured. No collection or acceptance of rent by Landlord from any transferee shall be deemed a waiver of any provision of Article 9 of this Lease, an approval of any transferee, or a release of Tenant from any obligation under this Lease,

whenever accruing. In no event shall Landlord's enforcement of any provision of this Lease against any transferee be deemed a waiver of Landlord's right to enforce any term of this Lease against Tenant or any other person.

## ARTICLE 10. INSURANCE AND INDEMNITY

**10.1. TENANT'S INSURANCE.** Tenant, at its sole cost and expense, shall provide and maintain in effect the insurance described in **Exhibit D**. Evidence of that insurance must be delivered to Landlord prior to the Commencement Date.

**10.2. LANDLORD'S INSURANCE.** Landlord shall provide the following types of insurance, with or without deductible and in amounts and coverages as may be determined by Landlord in its discretion: fire and extended coverage insurance for the Building and the Project (including all structural elements of the Building and the primary systems serving the Building), covering the full replacement cost of the Building and Project. In addition, Landlord may, at its election, obtain insurance coverages for such other risks as Landlord or its Mortgagees may from time to time deem appropriate, including earthquake and commercial general liability coverage. Landlord shall not be required to carry insurance of any kind on any tenant improvements or Alterations in the Premises installed by Tenant or its contractors or otherwise removable by Tenant (collectively, "**Tenant Installations**"), or on any trade fixtures, furnishings, equipment, interior plate glass, signs or items of personal property in the Premises, and Landlord shall not be obligated to repair or replace any of the foregoing items should damage occur. All proceeds of insurance maintained by Landlord upon the Building and Project shall be the property of Landlord, whether or not Landlord is obligated to or elects to make any repairs.

### 10.3. INDEMNITY.

(a) To the fullest extent permitted by law, but subject to Section 10.5 below, Tenant shall defend, indemnify and hold harmless Landlord, its agents, lenders, and any and all affiliates of Landlord, from and against any and all claims, liabilities, costs or expenses arising either before or after the Commencement Date from Tenant's use or occupancy of the Premises, the Building or the Common Areas, or from the conduct of its business, or from any activity, work, or thing done, permitted or suffered by Tenant or its agents, employees, subcontractors, vendors, contractors, invitees or licensees in or about the Premises, the Building or the Common Areas, or from any Default in the performance of any obligation on Tenant's part to be performed under this Lease, or from any act or negligence of Tenant or its agents, employees, subcontractors, vendors, contractors, invitees or licensees. Landlord may, at its option, require Tenant to assume Landlord's defense in any action covered by this Section 10.3 through counsel reasonably satisfactory to Landlord. Notwithstanding the foregoing, Tenant shall not be obligated to indemnify Landlord against any liability or expense to the extent it is ultimately determined that the same was caused by the negligence or willful misconduct of Landlord, its agents, invitees, contractors or employees; provided, further, Tenant shall not be liable for any such injury or damage, and Landlord shall reimburse Tenant for the reasonable attorneys' fees and costs for the attorney representing both parties, all to the extent and in the proportion that such injury or damage is ultimately determined by a court of competent jurisdiction (or in connection with any negotiated settlement agreed to by Landlord) to be attributable to the negligence or willful misconduct of Landlord.

(b) To the fullest extent permitted by law, but subject to the express limitations on liability contained in this Lease (including, without limitation, the provisions of Sections 10.4, 10.5 and 14.8 of this Lease), Landlord shall defend, indemnify, protect, save and hold harmless Tenant, its agents and any and all affiliates of Tenant, including without limitation, any corporations, or other entities controlling, controlled by or under common control with Tenant, from and against any and all claims, liabilities, costs or expenses arising either before or after the Commencement Date from the negligence or willful misconduct of Landlord, its employees, contractors or authorized agents ("**Landlord Parties**") in connection with the operation, maintenance or repair of the Building and/or Common Areas of the Project. The provisions of this subsection 10.3(b) shall expressly survive the expiration or sooner termination of this Lease.

(c) Notwithstanding anything to the contrary contained in this Lease, nothing in this Lease shall impose any obligations on Tenant or Landlord to be responsible or liable for, and each hereby releases the other from all liability for, consequential damages other than those consequential damages incurred by Landlord in connection with a holdover of the Premises by Tenant after the expiration or earlier termination of this Lease. Notwithstanding the foregoing, for purposes of this Lease, consequential damages shall not be deemed to include property damage or personal injury damages, nor any recovery by Landlord of the damages described in Section 14.2(a) of this Lease.

**10.4. LANDLORD'S NONLIABILITY.** Subject to the express indemnity obligations contained in Section 10.3(b) of this Lease, but regardless of the negligence of Landlord, its agents or affiliates, Landlord, its agents, and any and all affiliates of Landlord, Landlord shall not be liable to Tenant, its employees, agents and invitees, and Tenant hereby waives all claims against Landlord, its employees and agents for loss of or damage to any property, or any injury to any person, resulting from any condition including, but not limited to, acts or omissions (criminal or otherwise) of third parties and/or other tenants of the Project, or their agents, employees or invitees, fire, explosion, falling plaster, steam, gas, electricity, water or rain which may leak or flow from or into any part of the Premises or from the breakage, leakage, obstruction or other defects of the pipes, sprinklers, wires, appliances, plumbing, air conditioning, electrical works or other fixtures in the Building, whether the damage or injury results from conditions arising in the Premises or in other portions of the Building. It is understood that any such condition may

require the temporary evacuation or closure of all or a portion of the Building. Should Tenant elect to receive any service from a concessionaire, licensee or third party tenant of Landlord, Tenant shall not seek recourse against Landlord for any breach or liability of that service provider.

**10.5. WAIVER OF SUBROGATION.** Landlord and Tenant each hereby waives all rights of recovery against the other and the other's agents on account of loss and damage occasioned to the property of such waiving party to the extent that the waiving party is entitled to proceeds for such loss or damage under any property insurance policies carried or required to be carried by or self-insured pursuant to the provisions of this Lease; provided, however, that the foregoing waiver shall not apply to the extent of Tenant's obligations to pay deductibles under any such policies and this Lease. By this waiver it is the intent of the parties that neither Landlord nor Tenant shall be liable to any insurance company (by way of subrogation or otherwise) insuring the other party for any loss or damage insured against under any property insurance policies contemplated by this Lease, even though such loss or damage might be occasioned by the negligence of such party, its agents, employees, contractors, guests or invitees. If either party fails to carry the amounts and types of insurance required to be carried by it pursuant to this Article 10 or has elected to self-insure such obligations, then, in addition to any remedies the other party may have under this Lease, such failure or election shall be deemed to be a covenant and agreement by such party to self-insure with respect to the type and amount of insurance which such party either so failed to carry or elected to self-insure, respectively, with full waiver of subrogation with respect thereto.

## ARTICLE 11. DAMAGE OR DESTRUCTION

### 11.1. RESTORATION.

(a) If the Premises or the Building or a part thereof are materially damaged as the result of an event of casualty, then subject to the provisions below, Landlord shall repair that damage as soon as reasonably possible unless Landlord reasonably determines that: (i) the Premises have been materially damaged, there is less than 1 year of the Term remaining on the date of the casualty and Landlord reasonably determines that it would require more than sixty (60) days to repair, provided that Tenant may elect in such case, to cause this Lease to remain in effect by exercising any remaining option, if any, of Tenant to extend the Term of this Lease by written notice to Landlord within fifteen (15) days after delivery of Landlord's election to terminate; (ii) any Mortgagee (defined in Section 13.1) requires that the insurance proceeds be applied to the payment of the mortgage debt; or (iii) proceeds necessary to pay the full cost of the repair are not available from Landlord's insurance, including without limitation earthquake insurance, plus such additional amounts Tenant elects, at its option, to contribute, excluding however the deductible. Should Landlord elect not to repair the damage for one of the preceding reasons, Landlord shall so notify Tenant in the "Casualty Notice" (as defined below), and this Lease shall terminate as of the date of delivery of that notice.

(b) As soon as reasonably practicable following the casualty event but not later than 60 days thereafter, Landlord shall notify Tenant in writing ("**Casualty Notice**") as to (i) whether Landlord is terminating this Lease as a result of such material damage, or (ii) if Landlord is not terminating this Lease, the number of days within which Landlord estimates that the Premises, with reasonable diligence, are likely to be fully repaired. In the event Landlord elects to terminate this Lease, this Lease shall terminate as of the date specified for termination by Landlord's Notice (which termination date shall in no event be later than sixty (60) days following the date of the damage, or, if no such date is specified, such termination shall be the date of Landlord's Notice). If the anticipated repair period exceeds 270 days and if the damage is so extensive as to reasonably prevent Tenant's substantial use and enjoyment of the Premises, then either party may elect to terminate this Lease by written notice to the other within 10 days following delivery of the Casualty Notice. Tenant may also elect to terminate this Lease by written notice to Landlord if the casualty has occurred within the final twelve (12) months of the Term and such material damage has a materially adverse impact on Tenant's continued use of the Premises.

(c) In the event that neither Landlord nor Tenant terminates this Lease pursuant to this Section 11.1 as a result of material damage to the Building or Premises resulting from a casualty, Landlord shall repair all material damage to the Premises or the Building as soon as reasonably possible and this Lease shall continue in effect for the remainder of the Term. Landlord's repair of material damage shall be at Landlord's sole cost and expense except for any insurance deductible. Landlord shall have the right, but not the obligation, to repair or replace any other leasehold improvements made by Tenant or any Alterations (as defined in Section 7.3) constructed by Tenant as part of Landlord's repair of material damage, in which case Tenant shall make available to Landlord upon demand insurance proceeds from insurance required to be maintained by Tenant to the extent required by Landlord for such work. If Landlord elects to repair or replace such leasehold improvements and/or Alterations, all insurance proceeds available for such repair or replacement shall be made available to Landlord to the extent required by Landlord for such work. Landlord shall have no liability to Tenant in the event that the Premises or the Building has not been fully repaired within the time period specified by Landlord in the Casualty Notice to Tenant as described in Section 11.1(a). Notwithstanding the provisions of this Article 11, the repair of damage to the Premises to the extent such damage is not material shall be governed by Sections 7.1 and 7.2.

Notwithstanding anything to the contrary contained in this Section 11.1(c), if for any reasons other than delays caused by Tenant, or other matters beyond Landlord's reasonable control (not to exceed ninety (90) days), the Premises and/or the Building have not been substantially repaired within thirty (30) days following the time period specified in the Casualty Notice to Tenant as described in Section 11.1(a),

then Tenant may, by written notice to Landlord given at any time thereafter but prior to the actual date of the substantial completion of the repair of the Premises or the Building, elect to terminate this Lease effective thirty (30) days from and after the date of such notice; provided that if Landlord shall substantially complete such repairs on or before the effective date of such termination, then Tenant's election to terminate this Lease shall thereupon be cancelled and of no further force or effect. Notwithstanding the foregoing, if at any time during the construction period, Landlord reasonably determines that the substantial completion of said repairs will be delayed beyond the time period specified in the Casualty Notice (for reasons other than Tenant-caused delays and/or force majeure delays), then Landlord may notify Tenant in writing of such determination and of a new outside date for completion of such repairs, and Tenant must elect within ten (10) business days of delivery of such notice to either terminate this Lease or waive its right to terminate this Lease, provided such repairs are substantially completed within thirty (30) days following the new outside date established by Landlord in such notice to Tenant. Tenant's failure to elect to terminate this Lease within such ten (10) business day period shall be deemed Tenant's waiver of its right to terminate this Lease as provided in this paragraph as to the previous outside date, but not as to the new outside date established by said notice.

(d) Commencing on the date of such material damage to the Building, and ending on the sooner of the date the damage is repaired or the date this Lease is terminated, the rental to be paid under this Lease shall be abated in the same proportion that the Floor Area of the Premises that is rendered unusable by the damage from time to time bears to the total Floor Area of the Premises; provided, that, if the Premises is damaged such that the remainder of the Premises is not reasonably usable by Tenant for the conduct its business operations from such remaining portion and Tenant does not conduct its business operations therefrom, Landlord shall allow Tenant a total abatement of rent during the time and to the extent the Premises are unfit for occupancy for Tenant's permitted use, and not occupied by Tenant as a result of the subject damage.

(e) Landlord shall not be required to repair or replace any personal property or fixtures that Tenant is obligated to repair or replace pursuant to Section 7.1 or any other provision of this Lease and Tenant shall continue to be obligated to so repair or replace any such personal property or fixtures, notwithstanding any provisions to the contrary in this Article 11.

(f) Tenant shall fully cooperate with Landlord in removing Tenant's personal property and any debris from the Premises to facilitate all inspections of the Premises and the making of any repairs. Notwithstanding anything to the contrary contained in this Lease, if Landlord reasonably and in good faith believes there is a risk of injury to persons or damage to property from entry into the Building or Premises following any damage or destruction thereto, Landlord may restrict entry into the Building or the Premises by Tenant, its employees, agents and contractors in a non-discriminatory manner, without being deemed to have violated Tenant's rights of quiet enjoyment to, or made an unlawful detainer of, or evicted Tenant from, the Premises. Upon request, Landlord shall consult with Tenant to determine if there are safe methods of entry into the Building or the Premises solely in order to allow Tenant to retrieve files, data in computers, and necessary inventory, subject however to all indemnities and waivers of liability from Tenant to Landlord contained in this Lease and any additional indemnities and waivers of liability which Landlord may require.

**11.2. LEASE GOVERNS.** Tenant agrees that the provisions of this Lease, including without limitation Section 11.1, shall govern any damage or destruction and shall accordingly supersede any contrary statute or rule of law.

#### **ARTICLE 12. EMINENT DOMAIN**

Either party may terminate this Lease if any material part of the Premises is taken or condemned for any public or quasi-public use under Law, by eminent domain or private purchase in lieu thereof (a "**Taking**"). Landlord shall also have the right to terminate this Lease if there is a Taking of any portion of the Building or Project which would have a material adverse effect on Landlord's ability to profitably operate the remainder of the Building. The termination shall be effective as of the effective date of any order granting possession to, or vesting legal title in, the condemning authority. If this Lease is not terminated, Basic Rent and Tenant's Share of Operating Expenses shall be appropriately adjusted to account for any reduction in the square footage of the Building or Premises. All compensation awarded for a Taking shall be the property of Landlord and the right to receive compensation or proceeds in connection with a Taking are expressly waived by Tenant; provided, however, Tenant may file a separate claim for Tenant's personal property and Tenant's reasonable relocation expenses, provided the filing of the claim does not diminish the amount of Landlord's award. If only a part of the Premises is subject to a Taking and this Lease is not terminated, Landlord, with reasonable diligence, will restore the remaining portion of the Premises as nearly as practicable to the condition immediately prior to the Taking. Tenant agrees that the provisions of this Lease shall govern any Taking and shall accordingly supersede any contrary statute or rule of law.

#### **ARTICLE 13. SUBORDINATION; ESTOPPEL CERTIFICATE**

**13.1. SUBORDINATION.** Tenant accepts this Lease subject and subordinate to any mortgage(s), deed(s) of trust, ground lease(s) or other lien(s) now or subsequently arising upon the Premises, the Building or the Project, and to renewals, modifications, refinancings and extensions thereof (collectively referred to as a "**Mortgage**"). The party having the benefit of a Mortgage shall be referred to as a "**Mortgagee**". This clause shall be self-operative, but upon request from a Mortgagee, Tenant shall execute a commercially reasonable subordination and attornment agreement in favor of the Mortgagee,

provided such agreement provides a non-disturbance covenant benefiting Tenant. Alternatively, a Mortgagee shall have the right at any time to subordinate its Mortgage to this Lease. Upon request, Tenant, without charge, shall attorn to any successor to Landlord's interest in this Lease in the event of a foreclosure of any mortgage. Tenant agrees that any purchaser at a foreclosure sale or lender taking title under a deed-in-lieu of foreclosure shall not be responsible for any act or omission of a prior landlord, except as to any continuing non-monetary default, shall not be subject to any offsets or defenses Tenant may have against a prior landlord, except as to any continuing non-monetary default, and shall not be liable for the return of the security deposit to the extent it is not actually received by such purchaser or bound by any rent paid for more than the current month in which the foreclosure occurred. Tenant acknowledges that Landlord's Mortgagees and their successors-in-interest are intended third party beneficiaries of this Section 13.1.

Notwithstanding the foregoing in this Section to the contrary, as a condition precedent to the future subordination of this Lease to a future Mortgage, Landlord shall be required to provide Tenant with a commercially reasonable non-disturbance, subordination, and attornment agreement in favor of Tenant from any Mortgagee who comes into existence after the Commencement Date. Such non-disturbance, subordination, and attornment agreement in favor of Tenant shall provide that, so long as Tenant is paying the Rent due under the Lease and is not otherwise in default under the Lease beyond any applicable cure period, its right to possession and the other terms of the Lease shall remain in full force and effect. Such non-disturbance, subordination, and attornment agreement may include other commercially reasonable provisions in favor of the Mortgagee, including, without limitation, additional time on behalf of the Mortgagee to cure defaults of the Landlord and provide that (a) neither Mortgagee nor any successor-in-interest shall be bound by (i) any payment of the Rent, or other sum due under this Lease for more than 1 month in advance or (ii) any amendment or modification of the Lease made without the express written consent of Mortgagee or any successor-in-interest; (b) neither Mortgagee nor any successor-in-interest will be liable for (i) any act or omission or warranties of any prior landlord (including Landlord), except as to any continuing non-monetary default, (ii) the breach of any warranties or obligations relating to construction of improvements on the Building or any tenant finish work performed or to have been performed by any prior landlord (including Landlord), or (iii) the return of any Security Deposit, except to the extent such deposits have been received by Mortgagee; and (c) neither Mortgagee nor any successor-in-interest shall be subject to any offsets or defenses which Tenant might have against any prior landlord (including Landlord), except as to any continuing non-monetary default.

**13.2. ESTOPPEL CERTIFICATE.** Tenant shall, within ten (10) business days following written request from Landlord, execute, acknowledge and deliver to Landlord, in any form that Landlord may reasonably require, a statement in writing in favor of Landlord and/or any prospective purchaser or encumbrancer of the Building (i) certifying that this Lease is unmodified and in full force and effect (or, if modified, stating the nature of the modification and certifying that this Lease, as modified, is in full force and effect) and the dates to which the rental, additional rent and other charges have been paid in advance, if any, and (ii) acknowledging that, to Tenant's actual knowledge, there are no uncured defaults on the part of Landlord, or specifying each default if any are claimed, and (iii) setting forth all further information that Landlord or any prospective purchaser or encumbrancer may reasonably require. Tenant's statement may be relied upon by any prospective purchaser or encumbrancer of all or any portion of the Building or Project.

#### ARTICLE 14. DEFAULTS AND REMEDIES

**14.1. TENANT'S DEFAULTS.** The occurrence of any one or more of the following events (following the expiration of any cure period set forth below, if any is provided) shall constitute a "Default" by Tenant:

(a) The failure by Tenant to make any payment of Rent required to be made by Tenant, as and when due, where the failure continues for a period of five (5) business days after written notice from Landlord to Tenant. The term "**Rent**" as used in this Lease shall be deemed to mean the Basic Rent and all other sums required to be paid by Tenant to Landlord pursuant to the terms of this Lease

(b) The assignment, sublease, encumbrance or other Transfer of the Lease by Tenant, either voluntarily or by operation of law, whether by judgment, execution, transfer by intestacy or testacy, or other means, without the prior written consent of Landlord when consent is required by this Lease that is not terminated or rescinded within fifteen (15) days following written notice from Landlord.

(c) The discovery by Landlord that any financial statement provided by Tenant, or by any affiliate, successor or guarantor of Tenant, was materially false.

(d) Except where a specific time period is otherwise set forth for Tenant's performance in this Lease (in which event the failure to perform by Tenant within such time period shall be a Default), the failure or inability by Tenant to observe or perform any of the covenants or provisions of this Lease to be observed or performed by Tenant, other than as specified in any other subsection of this Section 14.1, where the failure continues for a period of 30 days after written notice from Landlord to Tenant. However, if the nature of the failure is such that more than 30 days are reasonably required for its cure, then Tenant shall not be deemed to be in Default if Tenant commences the cure within 30 days, and thereafter diligently pursues the cure to completion.

The notice periods provided herein are in lieu of, and not in addition to, any notice periods provided by law, and Landlord shall not be required to give any additional notice under California Code of

Civil Procedure Section 1161, or any successor statute, in order to be entitled to commence an unlawful detainer proceeding.

#### 14.2. LANDLORD'S REMEDIES.

(a) Upon the occurrence of any Default by Tenant, then in addition to any other remedies available to Landlord, Landlord may exercise the following remedies:

(i) Landlord may terminate Tenant's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Tenant shall immediately surrender possession of the Premises to Landlord. Such termination shall not affect any accrued obligations of Tenant under this Lease. Upon termination, Landlord shall have the right to reenter the Premises and remove all persons and property in accordance with applicable laws. Landlord shall also be entitled to recover from Tenant:

(1) The worth at the time of award of the unpaid Rent which had been earned at the time of termination;

(2) The worth at the time of award of the amount by which the unpaid Rent which would have been earned after termination until the time of award exceeds the amount of such loss that Tenant proves could have been reasonably avoided;

(3) The worth at the time of award of the amount by which the unpaid Rent for the balance of the Term after the time of award exceeds the amount of such loss that Tenant proves could be reasonably avoided;

(4) Any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result from Tenant's default, including, but not limited to, the cost of recovering possession of the Premises, commissions and other expenses of reletting, including necessary repair, the unamortized portion of any tenant improvements and brokerage commissions funded by Landlord in connection with this Lease, reasonable attorneys' fees, and any other reasonable costs; and

(5) At Landlord's election, all other amounts in addition to or in lieu of the foregoing as may be permitted by law. Any sum, other than Basic Rent, shall be computed on the basis of the average monthly amount accruing during the 24 month period immediately prior to Default, except that if it becomes necessary to compute such rental before the 24 month period has occurred, then the computation shall be on the basis of the average monthly amount during the shorter period. As used in subparagraphs (1) and (2) above, the "worth at the time of award" shall be computed by allowing interest at the rate of 10% per annum (the "Interest Rate"). As used in subparagraph (3) above, the "worth at the time of award" shall be computed by discounting the amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus 1%.

(ii) Landlord may elect not to terminate Tenant's right to possession of the Premises, in which event Landlord may continue to enforce all of its rights and remedies under this Lease, including the right to collect all rent as it becomes due. Efforts by the Landlord to maintain, preserve or relet the Premises, or the appointment of a receiver to protect the Landlord's interests under this Lease, shall not constitute a termination of the Tenant's right to possession of the Premises. In the event that Landlord elects to avail itself of the remedy provided by this subsection (ii), Landlord shall not unreasonably withhold its consent to an assignment or subletting of the Premises subject to the reasonable standards for Landlord's consent as are contained in this Lease.

(b) The various rights and remedies reserved to Landlord in this Lease or otherwise shall be cumulative and, except as otherwise provided by California law, Landlord may pursue any or all of its rights and remedies at the same time. No delay or omission of Landlord to exercise any right or remedy shall be construed as a waiver of the right or remedy or of any breach or Default by Tenant. The acceptance by Landlord of rent shall not be a (i) waiver of any preceding breach or Default by Tenant of any provision of this Lease, other than the failure of Tenant to pay the particular rent accepted, regardless of Landlord's knowledge of the preceding breach or Default at the time of acceptance of rent, or (ii) a waiver of Landlord's right to exercise any remedy available to Landlord by virtue of the breach or Default. The acceptance of any payment from a debtor in possession, a trustee, a receiver or any other person acting on behalf of Tenant or Tenant's estate shall not waive or cure a Default under Section 14.1. No payment by Tenant or receipt by Landlord of a lesser amount than the rent required by this Lease shall be deemed to be other than a partial payment on account of the earliest due stipulated rent, nor shall any endorsement or statement on any check or letter be deemed an accord and satisfaction and Landlord shall accept the check or payment without prejudice to Landlord's right to recover the balance of the rent or pursue any other remedy available to it. Tenant hereby waives any right of redemption or relief from forfeiture under California Code of Civil Procedure Section 1174 or 1179, or under any successor statute, in the event this Lease is terminated by reason of any Default by Tenant. No act or thing done by Landlord or Landlord's agents during the Term shall be deemed an acceptance of a surrender of the Premises, and no agreement to accept a surrender shall be valid unless in writing and signed by Landlord. No employee of Landlord or of Landlord's agents shall have any power to accept the keys to the Premises prior to the termination of this Lease, and the delivery of the keys to any employee shall not operate as a termination of the Lease or a surrender of the Premises.

**14.3. LATE PAYMENTS.** Any payment due to Landlord under this Lease, including without limitation Basic Rent, Tenant's Share of Operating Expenses or any other payments due to Landlord under this Lease whether or not designated as additional rent hereunder, that is not received by Landlord within five (5) business days following the date due shall bear interest at the Interest Rate from the date due until fully paid. The payment of interest shall not cure any breach or Event of Default by Tenant under this Lease. In addition, Tenant acknowledges that the late payment by Tenant to Landlord of Basic Rent and Tenant's Share of Operating Expenses will cause Landlord to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult and impracticable to ascertain. Those costs may include, but are not limited to, administrative, processing and accounting charges, and late charges which may be imposed on Landlord by the terms of any ground lease, mortgage or trust deed covering the Premises. Accordingly, if any Basic Rent or Tenant's Share of Operating Expenses due from Tenant shall not be received by Landlord or Landlord's designee within ten (10) days following the date due, then Tenant shall pay to Landlord, in addition to the interest provided above, a late charge, which the Tenant agrees is reasonable, in a sum equal to the greater of five percent (5%) of the amount overdue or One Hundred Dollars (\$100.00) for each delinquent payment; provided that Landlord shall waive the payment of said late charge for the initial delinquent payment of Basic Rent or Operating Expenses by Tenant during any twelve (12) month period during the Lease Term. Acceptance of a late charge by Landlord shall not constitute a waiver of Tenant's breach or Default with respect to the overdue amount, nor shall it prevent Landlord from exercising any of its other rights and remedies.

**14.4. RIGHT OF LANDLORD TO PERFORM.** All covenants and agreements to be performed by Tenant under this Lease shall be performed at Tenant's sole cost and expense and without any abatement of rent or right of set-off, except as otherwise expressly provided in this Lease. If Tenant fails to pay any sum of money, other than rent payable to Landlord, or fails to perform any other act on its part to be performed under this Lease, and the failure continues beyond any applicable grace period set forth in Section 14.1, then in addition to any other available remedies, Landlord may, following the continuation of and failure for a period of five (5) days following notice to Tenant, at its election make the payment or perform the other act on Tenant's part and Tenant hereby grants Landlord the right to enter onto the Premises in accordance with the provisions of Section 7.5, in order to carry out such performance. Landlord's election to make the payment or perform the act on Tenant's part shall not give rise to any responsibility of Landlord to continue making the same or similar payments or performing the same or similar acts nor shall Landlord be responsible to Tenant for any damage caused to Tenant as the result of such performance by Landlord. Tenant shall, within thirty (30) days following demand by Landlord, reimburse Landlord for all sums paid by Landlord and all necessary incidental costs, together with interest at the Interest Rate from the date of the payment by Landlord.

**14.5. DEFAULT BY LANDLORD.** Landlord shall not be deemed to be in default in the performance of any obligation under this Lease, and Tenant shall have no rights to take any action against Landlord, unless and until (i) in the event the failure by Landlord is with respect to the payment of money, Landlord fails to pay such unpaid amounts within five (5) business days of notice from Tenant that the same was not paid when due or (ii) Landlord has failed to perform the obligation within thirty (30) days after written notice by Tenant to Landlord specifying in reasonable detail the nature and extent of the failure; provided, however, that if the nature of Landlord's obligation is such that more than thirty (30) days are required for its performance, then Landlord shall not be deemed to be in default if it commences performance within the thirty (30) day period and thereafter diligently pursues the cure to completion. In the event of Landlord's default under this Lease, Tenant's sole remedies shall be to seek damages or specific performance from Landlord, provided that any damages shall be limited to Tenant's actual out-of-pocket expenses and shall in no event include any consequential damages, lost profits or opportunity costs.

**14.6. EXPENSES AND LEGAL FEES.** Should either Landlord or Tenant bring any action in connection with this Lease, the prevailing party shall be entitled to recover as a part of the action its reasonable attorneys' fees, and all other reasonable costs. The prevailing party for the purpose of this paragraph shall be determined by the trier of the facts.

**14.7. WAIVER OF JURY TRIAL/JUDICIAL REFERENCE.**

(a) **LANDLORD AND TENANT EACH ACKNOWLEDGE THAT IT IS AWARE OF AND HAS HAD THE ADVICE OF COUNSEL OF ITS CHOICE WITH RESPECT TO ITS RIGHT TO TRIAL BY JURY, AND, TO THE EXTENT ENFORCEABLE UNDER CALIFORNIA LAW, EACH PARTY DOES HEREBY EXPRESSLY AND KNOWINGLY WAIVE AND RELEASE ALL SUCH RIGHTS TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER PARTY HERETO AGAINST THE OTHER (AND/OR AGAINST ITS OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, OR SUBSIDIARY OR AFFILIATED ENTITIES) ON ANY MATTERS WHATSOEVER ARISING OUT OF OR IN ANY WAY CONNECTED WITH THIS LEASE, TENANT'S USE OR OCCUPANCY OF THE PREMISES, AND/OR ANY CLAIM OF INJURY OR DAMAGE.**

(b) **IN THE EVENT THAT THE JURY WAIVER PROVISIONS OF SECTION 14.7(a) ARE NOT ENFORCEABLE UNDER CALIFORNIA LAW, THEN THE PROVISIONS OF THIS SECTION 14.7(b) SHALL APPLY. IT IS THE DESIRE AND INTENTION OF THE PARTIES TO AGREE UPON A MECHANISM AND PROCEDURE UNDER WHICH CONTROVERSIES AND DISPUTES ARISING OUT OF THIS LEASE OR RELATED TO THE PREMISES WILL BE RESOLVED IN A PROMPT AND EXPEDITIOUS MANNER. ACCORDINGLY, EXCEPT WITH RESPECT TO ACTIONS FOR UNLAWFUL OR FORCIBLE DETAINER, WITH RESPECT TO THE PREJUDGMENT REMEDY OF ATTACHMENT, AND WITH RESPECT TO THE DETERMINATION OF FAIR MARKET RENTAL TO BE**

DETERMINED IN ACCORDANCE WITH THE PROVISIONS OF PARAGRAPH 1 OF EXHIBIT G OF THIS LEASE, ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER PARTY HERETO AGAINST THE OTHER (AND/OR AGAINST ITS OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR SUBSIDIARY OR AFFILIATED ENTITIES) ON ANY MATTERS WHATSOEVER ARISING OUT OF OR IN ANY WAY CONNECTED WITH THIS LEASE, TENANT'S USE OR OCCUPANCY OF THE PREMISES AND/OR ANY CLAIM OF INJURY OR DAMAGE, SHALL BE HEARD AND RESOLVED BY A REFEREE (WITHOUT A JURY) UNDER THE PROVISIONS OF THE CALIFORNIA CODE OF CIVIL PROCEDURE, SECTIONS 638 – 645.1, INCLUSIVE AND RULE 244.1 OF THE CALIFORNIA RULES OF COURT (AS SAME MAY BE AMENDED, OR ANY SUCCESSOR STATUTE(S) THERETO) (THE "REFEREE SECTIONS"). ANY FEE TO INITIATE THE JUDICIAL REFERENCE PROCEEDINGS SHALL BE PAID BY THE PARTY INITIATING SUCH PROCEDURE; PROVIDED HOWEVER, THAT ANY AND ALL COSTS AND FEES, INCLUDING ANY INITIATION FEE, OF SUCH PROCEEDINGS SHALL ULTIMATELY BE BORNE IN ACCORDANCE WITH SECTION 14.6 ABOVE. THE VENUE OF THE PROCEEDINGS SHALL BE IN THE COUNTY IN WHICH THE PREMISES ARE LOCATED. WITHIN TEN (10) BUSINESS DAYS OF RECEIPT BY ANY PARTY OF A WRITTEN REQUEST TO RESOLVE ANY DISPUTE OR CONTROVERSY PURSUANT TO THIS SECTION 14.7(b), THE PARTIES SHALL AGREE UPON A SINGLE REFEREE WHO SHALL TRY ALL ISSUES, WHETHER OF FACT OR LAW, AND REPORT A FINDING AND JUDGMENT ON SUCH ISSUES AS REQUIRED BY THE REFEREE SECTIONS. IF THE PARTIES ARE UNABLE TO AGREE UPON A REFEREE WITHIN SUCH TEN (10) BUSINESS DAY PERIOD, THEN ANY PARTY MAY THEREAFTER FILE A LAWSUIT IN THE COUNTY IN WHICH THE PREMISES ARE LOCATED FOR THE PURPOSE OF APPOINTMENT OF A REFEREE UNDER CALIFORNIA CODE OF CIVIL PROCEDURE SECTIONS 638 AND 640, AS SAME MAY BE AMENDED OR ANY SUCCESSOR STATUTE(S) THERETO. IF THE REFEREE IS APPOINTED BY THE COURT, THE REFEREE SHALL BE A NEUTRAL AND IMPARTIAL RETIRED JUDGE WITH SUBSTANTIAL EXPERIENCE IN THE RELEVANT MATTERS TO BE DETERMINED, FROM JAMS/ENDISPUTE, INC., THE AMERICAN ARBITRATION ASSOCIATION OR SIMILAR MEDIATION/ARBITRATION ENTITY. THE PROPOSED REFEREE MAY BE CHALLENGED BY ANY PARTY FOR ANY OF THE GROUNDS LISTED IN SECTION 641 OF THE CALIFORNIA CODE OF CIVIL PROCEDURE, AS SAME MAY BE AMENDED OR ANY SUCCESSOR STATUTE(S) THERETO. THE REFEREE SHALL HAVE THE POWER TO DECIDE ALL ISSUES OF FACT AND LAW AND REPORT HIS OR HER DECISION ON SUCH ISSUES, AND TO ISSUE ALL RECOGNIZED REMEDIES AVAILABLE AT LAW OR IN EQUITY FOR ANY CAUSE OF ACTION THAT IS BEFORE THE REFEREE, INCLUDING AN AWARD OF ATTORNEYS' FEES AND COSTS, AND THE FEES AND EXPENSES OF THE REFEREE, IN ACCORDANCE WITH CALIFORNIA LAW. THE REFEREE SHALL NOT, HOWEVER, HAVE THE POWER TO AWARD PUNITIVE DAMAGES, NOR ANY OTHER DAMAGES WHICH ARE NOT PERMITTED BY THE EXPRESS PROVISIONS OF THIS LEASE, AND THE PARTIES HEREBY WAIVE ANY RIGHT TO RECOVER ANY SUCH DAMAGES. THE PARTIES SHALL BE ENTITLED TO CONDUCT ALL DISCOVERY AS PROVIDED IN THE CALIFORNIA CODE OF CIVIL PROCEDURE, AND THE REFEREE SHALL OVERSEE DISCOVERY AND MAY ENFORCE ALL DISCOVERY ORDERS IN THE SAME MANNER AS ANY TRIAL COURT JUDGE, WITH RIGHTS TO REGULATE DISCOVERY AND TO ISSUE AND ENFORCE SUBPOENAS, PROTECTIVE ORDERS AND OTHER LIMITATIONS ON DISCOVERY AVAILABLE UNDER CALIFORNIA LAW. THE REFERENCE PROCEEDING SHALL BE CONDUCTED IN ACCORDANCE WITH CALIFORNIA LAW (INCLUDING THE RULES OF EVIDENCE), AND IN ALL REGARDS, THE REFEREE SHALL FOLLOW CALIFORNIA LAW APPLICABLE AT THE TIME OF THE REFERENCE PROCEEDING. IN ACCORDANCE WITH SECTION 644 OF THE CALIFORNIA CODE OF CIVIL PROCEDURE, THE DECISION OF THE REFEREE UPON THE WHOLE ISSUE MUST STAND AS THE DECISION OF THE COURT, AND UPON THE FILING OF THE STATEMENT OF DECISION WITH THE CLERK OF THE COURT, OR WITH THE JUDGE IF THERE IS NO CLERK, JUDGMENT MAY BE ENTERED THEREON IN THE SAME MANNER AS IF THE ACTION HAD BEEN TRIED BY THE COURT. THE PARTIES SHALL PROMPTLY AND DILIGENTLY COOPERATE WITH ONE ANOTHER AND THE REFEREE, AND SHALL PERFORM SUCH ACTS AS MAY BE NECESSARY TO OBTAIN A PROMPT AND EXPEDITIOUS RESOLUTION OF THE DISPUTE OR CONTROVERSY IN ACCORDANCE WITH THE TERMS OF THIS SECTION 14.7(b). TO THE EXTENT THAT NO PENDING LAWSUIT HAS BEEN FILED TO OBTAIN THE APPOINTMENT OF A REFEREE, ANY PARTY, AFTER THE ISSUANCE OF THE DECISION OF THE REFEREE, MAY APPLY TO THE COURT OF THE COUNTY IN WHICH THE PREMISES ARE LOCATED FOR CONFIRMATION BY THE COURT OF THE DECISION OF THE REFEREE IN THE SAME MANNER AS A PETITION FOR CONFIRMATION OF AN ARBITRATION AWARD PURSUANT TO CODE OF CIVIL PROCEDURE SECTION 1285 ET SEQ. (AS SAME MAY BE AMENDED OR ANY SUCCESSOR STATUTE(S) THERETO).

**14.8 SATISFACTION OF JUDGMENT.** The obligations of Landlord do not constitute the personal obligations of the individual partners, trustees, directors, officers, members or shareholders of Landlord or its constituent partners or members. Should Tenant recover a money judgment against Landlord, such judgment shall be satisfied only from the interest of Landlord in the Project and out of the rent, insurance proceeds, condemnation awards or other income from such property receivable by Landlord or out of consideration received by Landlord from the sale or other disposition of all or any part of Landlord's right, title or interest in the Project, and no action for any deficiency may be sought or obtained by Tenant.

#### ARTICLE 15. END OF TERM

**15.1. HOLDING OVER.** If Tenant holds over for any period after the Expiration Date (or earlier termination of the Term) without the prior written consent of Landlord, such possession shall constitute a tenancy at sufferance only and a Default by Tenant; such holding over with the prior written consent of

Landlord shall constitute a month-to-month tenancy commencing on the 1<sup>st</sup> day following the termination of this Lease and terminating 30 days following delivery of written notice of termination by either Landlord or Tenant to the other. In either of such events, possession shall be subject to all of the terms of this Lease, except that during the first sixty (60) days of such holdover, the monthly rental shall be one hundred fifty percent (150%) of Basic Rent for the month immediately preceding the date of termination and, thereafter, the monthly rental shall be 200% of the Basic Rent for the month immediately preceding the date of termination, subject to Landlord's right to modify same upon 30 days notice to Tenant. The acceptance by Landlord of monthly hold-over rental in a lesser amount shall not constitute a waiver of Landlord's right to recover the full amount due unless otherwise agreed in writing by Landlord. If Tenant fails to surrender the Premises upon the expiration of this Lease despite demand to do so by Landlord, Tenant shall indemnify and hold Landlord harmless from all loss or liability, including without limitation, any claims made by any succeeding tenant relating to such failure to surrender. The foregoing provisions of this Section 15.1 are in addition to and do not affect Landlord's right of re-entry or any other rights of Landlord under this Lease or at law.

**15.2. SURRENDER OF PREMISES; REMOVAL OF PROPERTY.** Subject to the provisions of Section 7.3 of this Lease and of the Work Letter, if any, attached hereto, upon the Expiration Date or upon any earlier termination of this Lease, Tenant shall quit and surrender possession of the Premises to Landlord in as good order, condition and repair as when received or as hereafter may be improved by Landlord or Tenant, reasonable wear and tear, damage and destruction condemnation and repairs which are Landlord's obligation excepted, and shall remove or fund to Landlord the cost of removing all wallpapering, voice and/or data transmission cabling installed by or for Tenant and Required Removables, together with all personal property and debris, and shall perform all work required under Section 7.3 of this Lease. All of Tenant's personal property, furniture (whether bolted or otherwise), furnishings, business machines, and equipment and trade fixtures (whether or not affixed to the Premises), signs, communications equipment, movable partitions, security equipment, networking equipment and viewing screens, A/V and video equipment, built-in television sets or projection screens, telecommunications equipment (including all telephone and data cabling), seating, projectors or other items bolted in place, free-standing cabinet work, computer systems, furnishings, uninterruptible power supply equipment, owned by Tenant and installed or placed by Tenant in the Premises, shall remain the property of Tenant, and may be removed by Tenant at any time during the Term of the Lease, provided that Tenant repairs any damage to the Premises as a result of the removal of same. If Tenant shall fail to comply with the provisions of this Section, Landlord may effect the removal and/or make any repairs, and the cost to Landlord shall be additional rent payable by Tenant within thirty (30) days of its receipt of a written invoice therefor. If requested by Landlord, Tenant shall execute, acknowledge and deliver to Landlord a commercially reasonable instrument in writing releasing and quitclaiming to Landlord all right, title and interest of Tenant in the Premises.

#### **ARTICLE 16. PAYMENTS AND NOTICES**

All sums payable by Tenant to Landlord shall be paid, without deduction or offset, except as otherwise expressly provided herein, in lawful money of the United States to Landlord at its address set forth in Item 12 of the Basic Lease Provisions, or at any other place as Landlord may designate in writing. Unless this Lease expressly provides otherwise, as for example in the payment of rent pursuant to Section 4.1, all payments shall be due and payable within thirty (30) days after demand. All payments requiring proration shall be prorated on the basis of the number of days in the pertinent calendar month or year, as applicable. Any notice, election, demand, consent, approval or other communication to be given or other document to be delivered by either party to the other may be delivered to the other party, at the address set forth in Item 12 of the Basic Lease Provisions, by personal service, or by any courier or "overnight" express mailing service. Either party may, by written notice to the other, served in the manner provided in this Article, designate a different address. The refusal to accept delivery of a notice, or the inability to deliver the notice (whether due to a change of address for which notice was not duly given or other good reason), shall be deemed delivery and receipt of the notice as of the date of attempted delivery. If more than one person or entity is named as Tenant under this Lease, service of any notice upon any one of them shall be deemed as service upon all of them.

#### **ARTICLE 17. RULES AND REGULATIONS**

Tenant agrees to comply with the Rules and Regulations attached as **Exhibit E**, and any reasonable and nondiscriminatory amendments, modifications and/or additions as may be adopted and published by written notice to tenants by Landlord for the safety, care, security, good order, or cleanliness of the Premises, Building, Project and/or Common Areas. Landlord shall not be liable to Tenant for any violation of the Rules and Regulations or the breach of any covenant or condition in any lease or any other act or conduct by any other tenant. One or more waivers by Landlord of any breach of the Rules and Regulations by Tenant or by any other tenant(s) shall not be a waiver of any subsequent breach of that rule or any other. Tenant's failure to keep and observe the Rules and Regulations shall constitute a breach under this Lease. In the case of any conflict between the Rules and Regulations and this Lease, this Lease shall be controlling. Notwithstanding anything to the contrary contained in this Lease, Landlord agrees that the Rules and Regulations shall not be enforced on a discriminatory basis against Tenant, nor modified or enforced by Landlord in a manner that would unreasonably interfere with Tenant's use of or access to the Premises, the Building, the Project, or the parking areas in accordance with Tenant's rights under this Lease.

## ARTICLE 18. BROKER'S COMMISSION

The parties recognize as the broker(s) who negotiated this Lease the firm(s) whose name(s) is (are) stated in Item 10 of the Basic Lease Provisions, and agree that Landlord shall be responsible for the payment of brokerage commissions to those broker(s) unless otherwise provided in this Lease. It is understood that Landlord's Broker represents only Landlord in this transaction and Tenant's Broker (if any) represents only Tenant. Each party warrants that it has had no dealings with any other real estate broker or agent in connection with the negotiation of this Lease, and agrees to indemnify and hold the other party harmless from any cost, expense or liability (including reasonable attorneys' fees) for any compensation, commissions or charges claimed by any other real estate broker or agent employed by the indemnifying party in connection with the negotiation of this Lease. The foregoing agreement shall survive the termination of this Lease.

## ARTICLE 19. TRANSFER OF LANDLORD'S INTEREST

In the event of any transfer of Landlord's interest in the Premises, and the assumption of Landlord's obligations under this Lease by the transferee occurring after the date of such transfer (other than in the case of a foreclosure, termination of a ground or underlying lease, or transfer in bankruptcy, in which cases no such assumption shall be required), the transferor shall be automatically relieved of all further obligations on the part of Landlord occurring after the date of such transfer, and the transferor shall be relieved of any obligation to pay any funds in which Tenant has an interest to the extent that such funds have been turned over, subject to that interest, to the transferee and Tenant is notified of the transfer as required by law. No Mortgagee to which this Lease is or may be subordinate shall be responsible in connection with the Security Deposit unless the Mortgagee actually receives the Security Deposit. It is intended that the covenants and obligations contained in this Lease on the part of Landlord shall, subject to the foregoing, be binding on Landlord, its successors and assigns, only during and with respect to obligations arising during their respective successive periods of ownership.

## ARTICLE 20. INTERPRETATION

**20.1. GENDER AND NUMBER.** Whenever the context of this Lease requires, the words "Landlord" and "Tenant" shall include the plural as well as the singular, and words used in neuter, masculine or feminine genders shall include the others.

**20.2. HEADINGS.** The captions and headings of the articles and sections of this Lease are for convenience only, are not a part of this Lease and shall have no effect upon its construction or interpretation.

**20.3. JOINT AND SEVERAL LIABILITY.** If more than one person or entity is named as Tenant, the obligations imposed upon each shall be joint and several and the act of or notice from, or notice or refund to, or the signature of, any one or more of them shall be binding on all of them with respect to the tenancy of this Lease, including, but not limited to, any renewal, extension, termination or modification of this Lease.

**20.4. SUCCESSORS.** Subject to Sections 13.1 and 22.3 and to Articles 9 and 19 of this Lease, all rights and liabilities given to or imposed upon Landlord and Tenant shall extend to and bind their respective heirs, executors, administrators, successors and assigns. Nothing contained in this Section 20.4 is intended, or shall be construed, to grant to any person other than Landlord and Tenant and their successors and assigns any rights or remedies under this Lease.

**20.5. TIME OF ESSENCE.** Time is of the essence with respect to the performance of every provision of this Lease in which time of performance is a factor.

**20.6. CONTROLLING LAW/VENUE.** This Lease shall be governed by and interpreted in accordance with the laws of the State of California without regard to choice of law principles. Subject to the terms of Section 14.7(b), should any litigation be commenced between the parties in connection with this Lease, such action shall be prosecuted in the applicable Superior Court in the county in which the Building is located.

**20.7. SEVERABILITY.** If any term or provision of this Lease, the deletion of which would not adversely affect the receipt of any material benefit by either party or the deletion of which is consented to by the party adversely affected, shall be held invalid or unenforceable to any extent, the remainder of this Lease shall not be affected and each term and provision of this Lease shall be valid and enforceable to the fullest extent permitted by law.

**20.8. WAIVER.** One or more waivers by Landlord or Tenant of any breach of any term, covenant or condition contained in this Lease shall not be a waiver of any subsequent breach of the same or any other term, covenant or condition. Consent to any act by one of the parties shall not be deemed to render unnecessary the obtaining of that party's consent to any subsequent act. No breach by Tenant or Landlord of this Lease shall be deemed to have been waived by the other unless the waiver is in a writing signed by the waiving party.

**20.9. INABILITY TO PERFORM.** In the event that either party shall be delayed or hindered in or prevented from the performance of any work or in performing any act required under this Lease by reason of any cause beyond the reasonable control of that party, then the performance of the work or the doing

of the act shall be excused for the period of the delay and the time for performance shall be extended for a period equivalent to the period of the delay. The provisions of this Section 20.9 shall not operate to excuse Tenant from the prompt payment of Rent.

**20.10. ENTIRE AGREEMENT.** This Lease and its exhibits and other attachments cover in full each and every agreement of every kind between the parties concerning the Premises, the Building, and the Project, and all preliminary negotiations, oral agreements, understandings and/or practices, except those contained in this Lease, are superseded and of no further effect. Each party waives its rights to rely on any representations or promises made by the other party or others which are not contained in this Lease. No verbal agreement or implied covenant shall be held to modify the provisions of this Lease, any statute, law, or custom to the contrary notwithstanding.

**20.11. QUIET ENJOYMENT.** Upon the observance and performance of all the covenants, terms and conditions on Tenant's part to be observed and performed without all applicable notice and cure periods, and subject to the other provisions of this Lease, Tenant shall have the right of quiet enjoyment, and subject to the other provisions of this Lease, Tenant shall have the right of quiet enjoyment and use of the Premises for the Term without hindrance or interruption by Landlord or any other person claiming by or through Landlord.

**20.12. SURVIVAL.** All covenants of Landlord or Tenant which reasonably would be intended to survive the expiration or sooner termination of this Lease, including without limitation any warranty or indemnity hereunder, shall so survive and continue to be binding upon and inure to the benefit of the respective parties and their successors and assigns.

**20.13. INTERPRETATION.** This Lease shall not be construed in favor of or against either party, but shall be construed as if both parties prepared this Lease.

## ARTICLE 21. EXECUTION AND RECORDING

**21.1. COUNTERPARTS.** This Lease may be executed in one or more counterparts, each of which shall constitute an original and all of which shall be one and the same agreement.

**21.2. CORPORATE, LIMITED LIABILITY COMPANY AND PARTNERSHIP AUTHORITY.** If Tenant is a corporation, limited liability company or partnership, Tenant hereby represents and warrants that each individual executing this Lease on behalf of Tenant is duly authorized to execute and deliver this Lease on behalf of the corporation, limited liability company or partnership, and that this Lease is binding upon the corporation, limited liability company or partnership in accordance with its terms. Tenant shall, at Landlord's request, deliver a certified copy of its board of directors' resolution, operating agreement or partnership agreement or certificate authorizing or evidencing the execution of this Lease.

**21.3. EXECUTION OF LEASE; NO OPTION OR OFFER** The submission of this Lease to Tenant shall be for examination purposes only, and shall not constitute an offer to or option for Tenant to lease the Premises. Execution of this Lease by Tenant and its return to Landlord shall not be binding upon Landlord, notwithstanding any time interval, until Landlord has in fact executed and delivered this Lease to Tenant, it being intended that this Lease shall only become effective upon execution by Landlord and delivery of a fully executed counterpart to Tenant.

**21.4. RECORDING.** Tenant shall not record this Lease without the prior written consent of Landlord. Tenant, upon the request of Landlord, shall execute and acknowledge a "short form" memorandum of this Lease for recording purposes.

**21.5. AMENDMENTS.** No amendment or mutual termination of this Lease shall be effective unless in writing signed by authorized signatories of Tenant and Landlord, or by their respective successors in interest. No actions, policies, oral or informal arrangements, business dealings or other course of conduct by or between the parties shall be deemed to modify this Lease in any respect.

**21.6. EXECUTED COPY.** Any fully executed photocopy or similar reproduction of this Lease shall be deemed an original for all purposes.

**21.7. ATTACHMENTS.** All exhibits, amendments, riders and addenda attached to this Lease are hereby incorporated into and made a part of this Lease.

## ARTICLE 22. MISCELLANEOUS

**22.1. NONDISCLOSURE OF LEASE TERMS.** Tenant acknowledges that the content of this Lease and any related documents are confidential information. Tenant agrees that it, and its partners, members, shareholders, officers, directors, employees and attorneys, shall not intentionally and voluntarily disclose, by public filings or otherwise, the terms and conditions of this Lease ("**Confidential Information**") to any third party, either directly or indirectly, without the prior written consent of Landlord, which consent may be given or withheld in Landlord's sole and absolute discretion. The foregoing restriction shall not apply if either: (i) Tenant is required to disclose the Confidential Information in response to a subpoena or other regulatory, administrative or court order, (ii) independent legal counsel to Tenant delivers a written opinion to Landlord that Tenant is required to disclose the Confidential Information to, or file a copy of this Lease with, any governmental agency or any stock exchange; provided however, that in such event, Tenant shall, before making any such disclosure (A) provide

Landlord with prompt written notice of such required disclosure, (B) at Tenant's sole cost, take all reasonable legally available steps to resist or narrow such requirement, including without limitation preparing and filing a request for confidential treatment of the Confidential Information and (C) if disclosure of the Confidential Information is required by subpoena or other regulatory, administrative or court order, Tenant shall provide Landlord with as much advance notice of the possibility of such disclosure as practical so that Landlord may attempt to stop such disclosure or obtain an order concerning such disclosure. The form and content of a request by Tenant for confidential treatment of the Confidential Information shall be provided to Landlord at least five (5) business days before its submission to the applicable governmental agency or stock exchange and is subject to the prior written approval of Landlord. In addition, Tenant may disclose the terms of this Lease to prospective assignees of this Lease and prospective subtenants under this Lease with whom Tenant is actively negotiating such an assignment or sublease. Notwithstanding the foregoing or anything to the contrary herein, Landlord acknowledges and agrees that Tenant shall be permitted to file a copy of this Lease (and any amendments or modifications thereto) in connection with its filings with the Securities and Exchange Commission.

**22.2. TENANT'S FINANCIAL STATEMENTS.** The application, financial statements and tax returns, if any, submitted and certified to by Tenant as an accurate representation of its financial condition have been prepared, certified and submitted to Landlord as an inducement and consideration to Landlord to enter into this Lease. Tenant shall during the Term furnish Landlord with current annual financial statements accurately reflecting Tenant's financial condition (or the financial condition of Tenant's parent to the extent financials for Tenant are prepared on a consolidated basis) upon written request from Landlord within 10 business days following Landlord's request (but not more frequently than twice in any calendar year during the Term); provided, however, that so long as Tenant is a publicly traded corporation on a nationally recognized stock exchange, the foregoing obligation to deliver the statements shall be waived. If delivered to Landlord marked or otherwise designated as "confidential," Landlord agrees that it will keep the financial statements confidential, except that Landlord shall have the right to deliver the same to any proposed purchaser of the Building or Project which agrees to maintain such confidentiality, and to any encumbrancer or proposed encumbrancer of all or any portion of the Building or Project which agrees to maintain such confidentiality.

**22.3. MORTGAGEE PROTECTION.** No act or failure to act on the part of Landlord which would otherwise entitle Tenant to be relieved of its obligations hereunder (other than abatement rights set forth herein) or to terminate this Lease shall result in such a release or termination unless (a) Tenant has given notice by registered or certified mail to any Mortgagee of a Mortgage covering the Building whose address has been furnished to Tenant in writing, and (b) such Mortgagee is afforded a reasonable opportunity to cure the default by Landlord (which shall in no event be less than 60 days), including, if necessary to effect the cure, time to obtain possession of the Building by power of sale or judicial foreclosure provided that such foreclosure remedy is diligently pursued. Tenant shall comply with any written directions by any Mortgagee to pay Rent due hereunder directly to such Mortgagee without determining whether a default exists under such Mortgagee's Mortgage (and Landlord hereby consents to such payment, notwithstanding that Landlord may later provide contrary instructions).

**22.4. SDN LIST.** Tenant hereby represents and warrants that neither Tenant nor, to Tenant's actual knowledge, any officer, director, employee, partner, member or other principal of Tenant (collectively, "**Tenant Parties**") is listed as a Specially Designated National and Blocked Person ("**SDN**") on the list of such persons and entities issued by the U.S. Treasury Office of Foreign Assets Control ("**OFAC**"). In the event Tenant or any Tenant Party is or becomes listed as an SDN, Tenant shall be deemed in breach of this Lease and Landlord shall have the right to terminate this Lease immediately upon written notice to Tenant.

**22.5. STANDARD OF CONSENT.** Except (i) for matters for which there is a standard of consent or discretion specifically set forth in this Lease; (ii) matters which could have an adverse effect on the Building structure or the Building systems, or which could adversely affect the exterior appearance of the Building, or (iii) matters covered by Sections 14.1 and 14.2 of this Lease (collectively, the "**Excepted Matters**"), any time the consent of Landlord or Tenant is required under this Lease, such consent shall not be unreasonably withheld or delayed, and, except with regard to the Excepted Matters, whenever this Lease grants Landlord or Tenant the right to take action, exercise discretion, establish Rules and Regulations or make an allocation or other determination, Landlord and Tenant shall act reasonably and in good faith.

**22.6. LANDLORD CONFIDENTIALITY.** Landlord agrees to keep any non-public information learned or discovered about Tenant, its operations, its employees and/or its customers confidential following the receipt of written notice from Tenant that Tenant is required to keep such information confidential in order to comply with any applicable law, statute, code, ordinance or regulation; provided, however, with respect to Landlord's employees, agents and/or contractors, Landlord shall only be required to use commercially reasonable efforts to advise such parties of the foregoing confidentiality requirements.

[signature block follows]

**LANDLORD:**

THE IRVINE COMPANY LLC,  
a Delaware limited liability company

By /s/ Steven M. Case  
Steven M. Case  
Executive Vice President  
Office Properties

By /s/ Betty Casties  
Betty Casties  
Vice President, Operations  
Office Properties

**TENANT:**

Spark Networks USA, LLC,  
a Delaware limited liability company

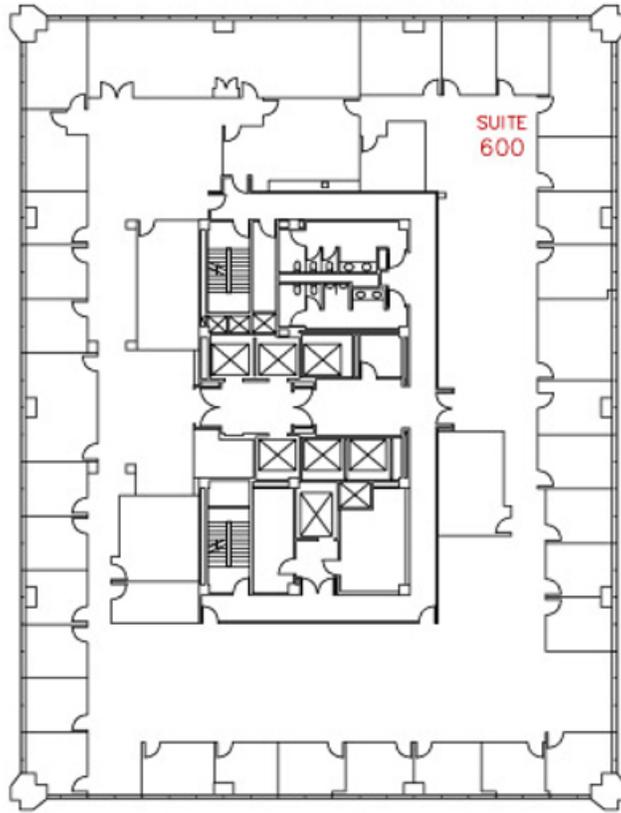
By /s/ Greg Liberman

Printed Name Greg Liberman

Title CEO / President

11150 Santa Monica Boulevard

Suite 600



 **Stevenson Systems, Inc.**  
©1985-2009 All Rights Reserved



EXHIBIT A

**EXHIBIT B**  
**OPERATING EXPENSES AND TAXES**  
**(Base Year)**

(a) Commencing 12 months following the Commencement Date, Tenant shall pay Landlord, as additional rent, for Tenant's Share of the amount, if any, by which "**Project Costs**" (defined below) for each Expense Recovery Period during the Term exceed Project Costs for the Project Cost Base and the amount, if any, by which "**Property Taxes**" (defined below) for each Expense Recovery Period during the Term exceed Property Taxes for the Property Tax Base. Property Taxes and Project Costs are mutually exclusive and may be billed separately or in combination as determined by Landlord. "**Tenant's Share**" shall mean that portion of any Operating Expenses determined by multiplying the cost of such item by a fraction, the numerator of which is the Floor Area of the Premises and the denominator of which is the total rentable square footage, as reasonably and equitably in good faith determined from time to time by Landlord, of (i) the Floor Area of the Building as defined in Item 8 of the Basic Lease Provisions, for expenses determined by Landlord to benefit or relate substantially to the Building rather than the entire Project, or (ii) all or some of the buildings in the Project, for expenses determined by Landlord to benefit or relate substantially to all or some of the buildings in the Project rather than any specific building. Tenant acknowledges Landlord's rights to make changes or additions to the Building and/or Project from time to time pursuant to Section 6.4 of the Lease, in which event the total rentable square footage within the Building and/or Project may be adjusted. For convenience of reference, Property Taxes and Project Costs may sometimes be collectively referred to as "**Operating Expenses**."

(b) Commencing prior to the start of the first full "**Expense Recovery Period**" of the Lease (as defined in Item 7 of the Basic Lease Provisions) following the Base Year, and prior to the start of each full or partial Expense Recovery Period thereafter, Landlord shall give Tenant a written estimate of the amount of Tenant's Share of Project Costs and Property Taxes for the Expense Recovery Period or portion thereof reflecting estimated Project Costs (detailed by major categories) and Property Taxes for the Expense Recovery Period. Commencing 12 months following the Commencement Date, Tenant shall pay the estimated amounts to Landlord in equal monthly installments, in advance, with Basic Rent. If Landlord has not furnished its written estimate for any Expense Recovery Period by the time set forth above, Tenant shall continue to pay cost reimbursements at the rates established for the prior Expense Recovery Period, if any; provided that when the new estimate is delivered to Tenant, Tenant shall, at the next monthly payment date occurring at least thirty (30) days following Landlord's delivery of such new estimate, pay any accrued cost reimbursements based upon the new estimate. Landlord may from time to time change the Expense Recovery Period to reflect a calendar year or a new fiscal year of Landlord, as applicable, in which event Tenant's share of Operating Expenses shall be equitably prorated for any partial year.

(c) Within 120 days after the end of each Expense Recovery Period, Landlord shall furnish to Tenant a statement setting forth the actual or prorated Property Taxes and Project Costs (detailed by major categories) attributable to that period, and the parties shall within 30 days thereafter make any payment or allowance from one to the other (or provide Tenant with a credit) necessary to adjust Tenant's estimated payments, if any, to Tenant's actual Tenant's Share as shown by the annual statement. Any delay or failure by Landlord in delivering any statement shall not constitute a waiver of Landlord's right to require Tenant to pay Tenant's Share of Operating Expenses pursuant hereto, provided, however, that Tenant shall not be responsible for the payment of any additional payments of Tenant's Share of Operating Expenses on account of any statement or any adjusted estimate of Tenant's Share of Operating Expenses, first delivered to Tenant more than two (2) calendar years following (i) the later of the expiration of the applicable Expense Recovery Period, or Landlord's delivery of the statement for the applicable Expense Recovery Period if delivered within one hundred twenty (120) days, or (ii) the date of the expiration of the Term (as the same may be extended), in each case except to the extent of any amounts due as Tenant's Share of Operating Expenses levied by any governmental authority or public utility which is not billed to Landlord until a date following the expiration of such two (2) calendar year period, so long as Landlord delivers to Tenant a supplemental statement with respect to such amounts not more than two (2) years following Landlord's receipt of the invoice for such amounts from the applicable governmental entity or public utility. If actual Property Taxes or Project Costs allocable to Tenant during any Expense Recovery Period are less than the Property Tax Base or the Project Cost Base, respectively, Landlord shall not be required to pay that differential to Tenant, although Landlord shall refund any applicable estimated payments collected from Tenant. Any amount due Tenant shall be credited against installments of Basic Rent or Tenant's Share of Operating Expenses (or estimated payment thereof) next coming due under this Lease, and any deficiency shall be paid by Tenant together with the next monthly payment date occurring at least thirty (30) days following Landlord's delivery of such new estimate. Should Tenant fail to object in writing to Landlord's determination of Tenant's Share of Operating Expenses, or fail to give written notice of its intent to audit Landlord's Operating Expenses pursuant to the provisions of the next succeeding paragraph, within one hundred eighty (180) days following delivery of Landlord's determination of Operating Expenses for the applicable Expense Recovery Period shall be conclusive and binding on the parties for all purposes and any future claims to the contrary shall be barred.

Provided no Default has occurred and is continuing, Tenant shall have the right to cause a certified public accountant or lease audit firm, engaged on a non-contingency fee basis, to audit Operating Expenses by inspecting Landlord's general ledger of expenses not more than once during any Expense Recovery Period; provided, however, Tenant shall be permitted to audit the Project Cost Base and the Property Tax Base in connection with its first audit of Operating Expenses for any Expense

Recovery Period. However, to the extent that insurance premiums or any other component of Operating Expenses is determined by Landlord on the basis of an internal allocation of costs utilizing information Landlord in good faith deems proprietary, such expense component shall not be subject to audit so long as it does not exceed the amount per square foot typically imposed by landlords of other first class buildings in the vicinity of the Project. Tenant shall give notice to Landlord of Tenant's intent to audit within one hundred eighty (180) days after delivery of Landlord's expense statement which sets forth Tenant's Share of Landlord's actual Operating Expenses to Tenant. Such audit shall be conducted at a mutually agreeable time during normal business hours at the office of Landlord or its management agent where such accounts are maintained. If Tenant's audit determines that actual Operating Expenses has been overstated by more than five percent (5%), then subject to Landlord's right to review and/or contest the audit results, Landlord shall reimburse Tenant for the reasonable out-of-pocket costs of such audit. Tenant's rent shall be appropriately adjusted to reflect any overstatement in Operating Expenses. All of the information obtained by Tenant and/or its auditor in connection with such audit, as well as any compromise, settlement, or adjustment reached between Landlord and Tenant as a result thereof, shall be held in strict confidence and, except as may be required pursuant to litigation, shall not be disclosed to any third party, directly or indirectly, by Tenant or its auditor or any of their officers, agents or employees. Landlord may require Tenant's auditor to execute a separate confidentiality agreement affirming the foregoing as a condition precedent to any audit. In the event of a violation of this confidentiality covenant in connection with any audit, then in addition to any other legal or equitable remedy available to Landlord, Tenant shall forfeit its right to any reconciliation or cost reimbursement payment from Landlord due to said audit (and any such payment theretofore made by Landlord shall be promptly returned by Tenant). Notwithstanding the foregoing, Tenant shall have no right of audit with respect to any Expense Recovery Period unless the total Operating Expenses per square foot for such Expense Recovery Period, as set forth in Landlord's annual expense statement, exceed the total Operating Expenses per square foot during the initial Expense Recovery Period during the Term, as increased by the percentage change in the United States Department of Labor, Bureau of Labor Statistics, Consumer Price Index for all Urban Consumers, Los Angeles—Riverside—Orange County Area Average, all items (1982-84 = 100) (the "**Index**"), which change in the Index shall be measured by comparing the Index published for January of the initial Expense Recovery Period during the Term with the Index published for January of the applicable Expense Recovery Period.

(d) Even though the Lease has terminated or expired and the Tenant has vacated the Premises, when the final determination is made of Tenant's share of Property Taxes and Project Costs for the Expense Recovery Period in which the Lease terminates, Tenant shall, within thirty (30) days of written notice, pay the entire increase due over the estimated expenses paid; conversely, any overpayment made in the event expenses decrease shall be rebated by Landlord to Tenant not later than thirty (30) days after such final determination.

(e) except as otherwise set forth in this Exhibit B, the term "**Project Costs**" shall, except as otherwise provided herein, include all charges and expenses pertaining to the operation, management, maintenance and repair of the Building and the Project, together with all appurtenant Common Areas (as defined in Section 6.2), consistently applied, and shall include the following charges by way of illustration but not limitation: water and sewer charges; insurance premiums or reasonable premium equivalents should Landlord elect to self-insure any risk or deductible that Landlord is authorized to insure hereunder; license, permit, and inspection fees; heat; light; power; janitorial services; the cost of equipping, staffing and operating an on-site and/or off-site management office for the Building and Project; all labor and labor-related costs for personnel to the level of portfolio manager or portfolio engineer directly applicable to the Building and/or Project, including both Landlord's personnel and outside personnel, provided that if any personnel provide service to the Project and to other properties of Landlord, the wages and salaries, fringe benefits and payroll taxes for such personnel shall be allocated to the Project based on the proportion of time spent in providing service to the Project as reasonably determined by Landlord; a commercially reasonable Landlord overhead/management fee (not to exceed 5% of gross receipts for the Building); reasonable fees for consulting services; access control/security costs, inclusive of the reasonable cost of improvements made to enhance access control systems and procedures; repairs; air conditioning; supplies; materials; equipment; tools; tenant services; programs instituted to comply with transportation management requirements; any expense incurred pursuant to Sections 6.1, 6.2, 6.4, 7.2, and 10.2 and **Exhibits C and F** below; the amortized costs incurred (capital or otherwise) on a regular recurring basis every three (3) or more years for normal maintenance projects (e.g., parking lot slurry coat or replacement of lobby, corridor and elevator cab carpets and coverings); and the amortized cost of capital improvements, repairs or expenditures (as well as the cost incurred for uninsured earthquake repairs or the deductible with respect to any insured earthquake repairs) (as distinguished from replacement parts or components installed in the ordinary course of business) (A) which are intended to maintain the safety of the Building and/or Project or intended as a labor-saving device or to effect other economies in the operation or maintenance of the Project, or any portion thereof, to the extent of cost savings reasonably anticipated by Landlord at the time of such expenditure to be incurred in connection therewith, or (B) that are required under any governmental law or regulation, except for capital repairs, replacements or other improvements to remedy a condition existing as of the Commencement Date which an applicable governmental authority, if it had knowledge of such condition as of the Commencement Date, would have then required to be remedied pursuant to then-current governmental laws or regulations in their form existing as of the Commencement Date (which shall be determined based upon the remedial requirements generally imposed by the applicable governmental authority in similar circumstances at comparable projects in the immediate vicinity of the Project as of the Commencement Date); provided, however, Landlord shall amortize the cost of any such permitted capital improvements on a straight-line basis over the lesser of the Payback Period (as defined below) or the useful life of the capital improvement as reasonably determined by Landlord. Any amortized Project Cost item may include, at

Landlord's option, an actual or imputed interest rate that Landlord would reasonably be required to pay to finance the cost of the item, applied on the unamortized balance. "Payback Period" shall mean the reasonably estimated period of time that it takes for the cost savings, if any, resulting from a capital improvement item to equal the total cost of the capital improvement. It is understood that Project Costs shall include competitive charges for direct services provided by any subsidiary or division of Landlord. If any Project Cost are applicable to one or more buildings or properties in addition to the Building, then that cost shall be equitably prorated and apportioned among the Building and such other buildings or properties. The term "Property Taxes" as used herein shall include the following: (i) all real estate taxes or personal property taxes, as such property taxes may be reassessed from time to time; and (ii) other taxes, charges and assessments which are levied with respect to this Lease or to the Building and/or the Project, and any improvements, fixtures and equipment and other property of Landlord located in the Building and/or the Project, except that general net income and franchise taxes imposed against Landlord shall be excluded; and (iii) any tax, surcharge or assessment which shall be levied in addition to or in lieu of real estate or personal property taxes; and (iv) costs and expenses incurred in contesting the amount or validity of any Property Tax by appropriate proceedings. A copy of Landlord's unaudited statement of expenses shall be made available to Tenant upon request. The Project Costs, inclusive of those for the Base Year, shall be extrapolated by Landlord to reflect at least ninety-five percent (95%) occupancy of the rentable area of the Building. To the extent Landlord obtains a tax refund, such tax refund shall be credited against Property Taxes based upon the applicable Expense Recovery Period to which such refund is applicable and Tenant shall be entitled to Tenant's Share of Operating Expenses of such refund to the extent of the Property Taxes included in Operating Expenses for such Expense Recovery Period. All special assessments which may be paid in installments and which are not specifically to be charged to Tenant under this Lease, shall be paid by Landlord in the maximum number of installments permitted by law and only to the installment paid in any Expense Recovery Period shall be included in Property Taxes in such Expense Recovery Period. Notwithstanding the foregoing, general net income or franchise taxes imposed against Landlord shall be excluded. Notwithstanding anything to the contrary contained in this Exhibit B, there shall be excluded from Property Taxes (A) all excess profits taxes, franchise taxes, gift taxes, capital stock taxes, inheritance and succession taxes, estate taxes, federal and state income taxes, and other taxes to the extent applicable to Landlord's general or net income (as opposed to rents, receipts or income attributable to operations at the Project), (B) any items included as Project Costs, and (C) any tax penalties incurred as a result of Landlord's failure to make any tax payments or to file tax returns when due.

(f) Notwithstanding anything to the contrary set forth herein, the amount of Property Taxes for the Base Year shall be calculated without taking into account any decreases in Property Taxes obtained in connection with Proposition 8 (as adopted by the voters of the State of California and as amended from time to time), provided that (i) any costs and expenses incurred by Landlord in securing any Proposition 8 reduction shall not be deducted from Taxes for the Base Year, and (ii) refunds of Property Taxes under Proposition 8 shall not be deducted from Property Taxes for the Base Year, but shall be the sole property of Landlord. All special assessments which may be paid in installments and which are not specifically to be charged to Tenant under this Lease, shall be paid by Landlord in the maximum number of installments permitted by law and only to the installment paid in any Expense Recovery Period shall be included in Property Taxes in such Expense Recovery Period. Notwithstanding the foregoing, general net income or franchise taxes imposed against Landlord shall be excluded. Notwithstanding anything to the contrary contained in this Exhibit B, there shall be excluded from Property Taxes (A) all excess profits taxes, franchise taxes, gift taxes, capital stock taxes, inheritance and succession taxes, estate taxes, federal and state income taxes, and other taxes to the extent applicable to Landlord's general or net income (as opposed to rents, receipts or income attributable to operations at the Project), (B) any items included as Project Costs, and (C) any tax penalties incurred as a result of Landlord's failure to make any tax payments or to file tax returns when due.

(g) Notwithstanding the foregoing, for purposes of this Lease, "Project Costs" shall not, however, include (i) principal payments, late charges, penalties, liquidated damages, bad-debt expenses, interest and amortization on mortgages, or ground lease payments, if any; (ii) real estate brokers' leasing commissions; (iii) the cost of providing any service directly to and paid directly by any tenant; (iv) the cost of Property Taxes and any other costs expressly excluded from Operating Expenses elsewhere in this Lease; (v) costs of any items to the extent Landlord receives reimbursement from insurance proceeds or from a third party other than as payment of its share of Operating Expenses (such costs to be credited or excluded, as applicable, from Operating Expenses in the year in which reimbursement is received); (vi) costs of capital improvements, repairs, alterations and equipment, except to the extent expressly identified in subsection (f) above; (vii) marketing costs, including leasing commissions, advertising and promotional expenses, space planning costs and attorneys' fees incurred in connection with the negotiation and preparation of letters, deal memos, letters of intent, leases, and subleases and/or assignments incurred in connection with present or prospective tenants or other occupants of the Project, including attorneys' fees and other costs and expenditures incurred in connection with disputes with present or prospective tenants or other occupants of the Project; (viii) costs, including permit, license and inspection costs and any allowances or other tenant improvement concessions, incurred or provided with respect to the design, construction and/or installation of other tenants' or occupants' improvements made for tenants or other occupants in the Project or incurred in renovating or otherwise improving, decorating, painting or redecorating vacant space for tenants or other occupants in the Project; (ix) rentals and other related expenses incurred in leasing a heating, ventilation and air conditioning system, elevators, or other items (except equipment not affixed to the Project which is used in providing janitorial or similar services to the Project and, further excepting from this exclusion such equipment rented or leased to remedy or ameliorate an emergency condition in the Project) which, if purchased, rather than rented, would constitute a capital improvement not permitted to be included in Operating Expenses pursuant to this

Lease; (x) depreciation, amortization and interest payments, except as to reserves or other amounts specifically included in Operating Expenses pursuant to the terms of this Lease, but not excluding from Operating Expenses, depreciation, amortization and interest payments on materials, tools, supplies and vendor-type equipment purchased by Landlord to enable Landlord to supply services Landlord might otherwise contract for with a third party (where such depreciation, amortization and interest payments would otherwise have been included in the charge for such third party's services, all as determined in accordance with sound real estate management principles, consistently applied, provided, that when depreciation or amortization is so permitted or required, the item shall be depreciated or amortized over its reasonably anticipated useful life); (xi) expenses in connection with services or other benefits which are not offered to Tenant or which Tenant is charged for directly, but which are provided to another tenant or occupant of the Project without charge; (xii) overhead and profit increment paid to Landlord or its affiliated, subsidiaries or parent entities for goods and/or services in the Project, to the extent the same exceeds the costs which would be incurred for the same if provided by unaffiliated third parties on a competitive basis; (xiii) advertising and promotional expenditures, and costs of installing signs in or on the Project identifying Landlord or any third party for advertising or promotional purposes; (xiv) tax penalties incurred as a result of Landlord's negligence, inability or unwillingness to make tax payments or file tax returns when due; (xv) legal fees and costs concerning the negotiation and preparation of this Lease or any litigation between Landlord and Tenant; (xvi) costs arising from Landlord's charitable or political contributions; (xvii) costs associated with the operation of the business of the partnership or entity which constitutes the Landlord, as the same are distinguished from the costs of the operation, management, repair, replacement and/or maintenance of the Premises, Building or the Project, including costs of defending any lawsuits with any mortgagee (except as the actions of the Tenant may be in issue), costs of selling, syndicating, financing, mortgaging or hypothecating any of the Landlord's interest in the Project and costs incurred in disputes between Landlord and its employees, managers, or other tenants or occupants; (xviii) amounts paid as ground rental or as rental for the Project by the Landlord; (xix) costs incurred to comply with applicable law with respect to hazardous or toxic materials, which exist at the Project as of the Commencement Date or which are not otherwise the responsibility of Tenant under any provision of this Lease; (xx) any entertainment, dining or travel expenses, except in connection with the operation, maintenance, repair, replacement or management of the Premises, the Building or the Project; (xxi) in the event any facilities, services or utilities used in connection with the Project are provided from another building owned or operated by Landlord or vice versa, the costs incurred by Landlord in connection therewith shall be allocated to Operating Expenses by Landlord on a reasonably equitable basis; (xxii) legal fees and costs, settlements, judgments or awards paid or incurred because of disputes between Landlord and Tenant, Landlord and other tenants or prospective occupants or tenants or Landlord and providers of goods and services to the Project (provided that if such dispute results in a reduction of Project Costs, such reduction shall be limited to the net costs of the reduction after recovery of the costs incurred in such dispute); (xxiii) the costs of any flowers, gifts, balloons, etc. provided to any prospective tenants, Tenant, other tenants, and occupants of buildings; (xxiv) all items and services for which Tenant or another tenant of the Project, if any, is obligated to reimburse Landlord, other than as payment of its share of Operating Expenses, or which Landlord selectively provides to one or more tenants of the Project (and does not provide to Tenant), if any, without reimbursement; (xxv) costs arising from the gross negligence or willful misconduct of Landlord or Landlord Parties; (xxvi) costs for in-house legal or accounting personnel other than bookkeeping personnel responsible for operating expenses as to Landlord's properties, including the Operating Expenses; (xxvii) costs actually reimbursed to Landlord under any warranty covering the Building or the Project; (xxviii) costs of magazine and newspaper subscriptions maintained by Landlord; and (xxix) costs for which Landlord would have received insurance proceeds had Landlord maintained insurance coverages that Landlord is required to maintain under this Lease or if Landlord had used commercially reasonable efforts (as determined by Landlord in its discretion) to enforce such insurance coverages. To the extent that Project Costs include charges to Landlord from third parties, Landlord shall include in Project Costs only the actual costs ("**Actual Costs**") charged to Landlord by such third parties for the same and Landlord shall not collect more than 100% of Project Costs from Building tenants and third parties.

**EXHIBIT C**  
**UTILITIES AND SERVICES**

The following standards for utilities and services shall be in effect at the Building. Landlord reserves the right to adopt reasonable nondiscriminatory modifications and additions to these standards. In the case of any conflict between these standards and the Lease, the Lease shall be controlling. Subject to all of the provisions of the Lease, including but not limited to the restrictions contained in Section 6.1, the following shall apply:

1. Landlord shall make available to the Premises during the hours of 8:00 a.m. to 6:00 p.m., Monday through Friday, and if requested by Tenant, from 8:00 a.m. to 1:00 p.m. on Saturday ("**Building Hours**"), generally recognized national holidays, which currently include New Year's Day, President's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, the Day after Thanksgiving and Christmas Day, excepted, reasonable HVAC services for normal office comfort. Subject to the provisions set forth below, Landlord shall also furnish 24 hours per day, 7 days per week, the Building with passenger and freight elevator service, reasonable amounts of electric current for normal lighting and for the operation of office equipment consistent in type and quantity with that utilized by typical office tenants of the Building and Project, and water for lavatory and toilet purposes in the Common Areas and for a typical office kitchen within the Premises. Tenant will not, without the prior written consent of Landlord (which shall not be unreasonably withheld), connect any apparatus, machine or device with water pipes or electric current (except through then existing or subsequently installed electrical outlets in the Premises) for the purpose of using electric current or water.

2. Upon written request from Tenant delivered to Landlord at least 2 hours prior to the period for which service is requested, but during normal business hours, Landlord will provide any of the foregoing building services to Tenant at such times when such services are not otherwise available. Tenant agrees to pay Landlord for those after-hour services at rates that Landlord may establish from time to time but consistent with comparable high-rise office buildings in the vicinity owned by Landlord. As of the date hereof, current after hours HVAC is Eighty-Four Dollars (\$84.00) per hour, and thereafter shall be subject to annual adjustments, which shall not exceed Five Dollars (\$5.00) per year on a compounding and cumulative basis, subject to change from time to time. If Tenant requires electric current in excess of that which Landlord is obligated to furnish under this **Exhibit C**, Tenant shall first obtain the consent of Landlord, and Landlord may cause an electric current meter to be installed in the Premises to measure the amount of electric current consumed. The cost of installation, maintenance and repair of the meter shall be paid for by Tenant, and Tenant shall reimburse Landlord promptly upon demand for all electric current consumed for any special power use as shown by the meter. The reimbursement shall be at the rates charged for electrical power by the local public utility furnishing the current, plus any additional expense incurred in keeping account of the electric current consumed.

3. Landlord shall furnish water for drinking, personal hygiene, lavatory and typical office kitchen purposes only.

4. In the event that any utility service to the Premises is separately metered or billed to Tenant, Tenant shall pay all charges for that utility service to the Premises and the cost of furnishing the utility to tenant suites shall be excluded from the Operating Expenses as to which reimbursement from Tenant is required in the Lease.

5. Landlord shall provide janitorial services 5 days per week, equivalent to that furnished in comparable buildings, and window washing as reasonably required; provided, however, that Tenant shall pay for any additional or unusual janitorial services required by reason of any nonstandard improvements in the Premises. At a minimum the janitorial services, shall comply with the specifications attached hereto as **Exhibit H**.

6. Tenant shall have access to the Building 24 hours per day, 7 days per week, 52 weeks per year; provided that Landlord may install commercially reasonable access control systems as it deems advisable for the Building. Landlord may impose a reasonable charge for access control cards and/or keys issued to Tenant. Landlord's charge for the initial 75 access control cards will be discounted and, in the aggregate, not exceed the lesser of Landlord's actual costs or \$1,200.

7. The costs of operating, maintaining and repairing any supplemental air conditioning unit serving only the Premises shall be borne solely by Tenant. Such costs shall include all metered electrical charges as described above in this Exhibit, together with the cost, as reasonably estimated by Landlord, to supply cooling water or other means of heat dissipation for the unit. Should Tenant desire to install such a unit, the plans and specifications must be submitted in advance to Landlord and reasonably approved in writing by Landlord in accordance with the terms of Section 7.3 above or the Work Letter. Such installation shall be at Tenant's sole expense (subject to the Landlord Contribution) and shall include installation of a separate meter for the operation of the unit. At the time Landlord consents to the installation of any such unit, Landlord may require Tenant to remove at Lease expiration any such unit installed by or for Tenant and to repair any resulting damage to the Premises or Building.

8. Tenant shall be permitted to install and operate its own security system within the Premises (including access readers), provided such system does not interfere with any Building systems. The plans for any such system shall be subject to Landlord's prior written reasonable approval and the requirements of Section 7.3 shall apply thereto or the Work Letter. Upon termination of this Lease,

---

Tenant shall remove the system and restore any affected areas to Building standard condition. All costs of installation, operation, maintenance and removal of the system shall be borne solely by Tenant (subject to the Landlord Contribution), and Landlord shall have no liability for the inadequacy or malfunction of that system. Tenant shall have the right, at no additional charge, to secure elevator access to any full floors occupied by Tenant.

9. Tenant shall be permitted, at its sole cost and expense, to contract with any telecommunications service, fiber optic, internet service or other media providers of its choice subject to working with Landlord and its Riser Management Firm Horizon Communications, and notwithstanding the foregoing, Tenant at no additional cost, shall have (i) the right to use the existing Building's risers and/or install additional risers for Tenant's cabling subject to space availability, and (ii) access to all areas within the Premises and Building, subject to Landlord's prior reasonable approval, including the Building's MPOE (main point of entry), to install the required infrastructure to service Tenant's IT and telecommunications requirements; provided, however, that all such providers shall be subject to Landlord's approval, which approval shall not be unreasonably withheld, conditioned or delayed; provided, further, installation of facilities and equipment by such providers shall be subject to the terms and provisions of Section 7.3 of this Lease or of the Work Letter (as the case may be), or any other provision of this Lease governing access to the roof or other portions of the Project required for such installation and the amount of cabling installed by Tenant shall be subject to Landlord's prior reasonable approval.

## EXHIBIT D

### TENANT'S INSURANCE

The following requirements for Tenant's insurance shall be in effect during the Term, and Tenant shall also cause any subtenant to comply with the requirements. Landlord reserves the right to adopt reasonable nondiscriminatory modifications and additions to these requirements.

1. Tenant shall maintain, at its sole cost and expense, during the entire Term: (i) commercial general liability insurance with respect to the Premises and the operations of Tenant in, on or about the Premises, including but not limited to coverage for personal injury, contractual liability, independent contractors, broad form property damage, fire legal liability, products liability (if a product is manufactured within or sold from the Premises), and liquor law liability (if alcoholic beverages are sold, served or consumed within the Premises), which policy(ies) shall be written on an "occurrence" basis and for not less than \$2,000,000 combined single limit per occurrence for bodily injury, death, and property damage liability; (ii) workers' compensation insurance coverage as required by law, together with employers' liability insurance coverage of at least \$1,000,000 each accident and each disease; (iii) with respect to Alterations constructed by Tenant under this Lease, builder's risk insurance, in an amount equal to the replacement cost of the work; and (iv) insurance against fire, vandalism, malicious mischief and such other additional perils as may be included in a standard "special form" policy, insuring all Alterations, trade fixtures, furnishings, equipment and items of personal property in the Premises, in an amount equal to not less than 90% of their replacement cost (with replacement cost endorsement), which policy shall also include business interruption coverage in an amount reasonably determined by Tenant, but in no event less than the equivalent of one (1) year's rent payable to Landlord. In no event shall the limits of any policy be considered as limiting the liability of Tenant under this Lease. Tenant may provide any of the insurance required herein pursuant to umbrella or blanket policies of insurance.

2. All policies of insurance required to be carried by Tenant pursuant to this **Exhibit D** shall be written by insurance companies authorized to do business in the State of California and with a general policyholder rating of not less than "A-" and financial rating of not less than "VII" in the most current Best's Insurance Report. The deductible or other retained limit under any policy carried by Tenant shall be commercially reasonable, and Tenant shall be responsible for payment of such deductible or retained limit with waiver of subrogation in favor of Landlord. Any insurance required of Tenant may be furnished by Tenant under any blanket policy carried by it or under a separate policy. A certificate of insurance, certifying that the policy has been issued, provides the coverage required by this Exhibit and contains the required provisions, together with endorsements, if required to comply with the requirements of this Exhibit D, reasonably acceptable to Landlord evidencing the waiver of subrogation and additional insured provisions required below, shall be delivered to Landlord prior to the date Tenant is given the right of possession of the Premises. Proper evidence of the renewal of any insurance coverage shall also be delivered to Landlord not less than ten (10) days prior to the expiration of the coverage. In the event of a loss covered by any policy under which Landlord is an additional insured, Landlord shall be entitled to review a copy of such policy.

3. Tenant's commercial general liability insurance shall contain a provision that the policy shall be primary to and noncontributory with any policies carried by Landlord, together with a provision including Landlord and any other parties in interest designated by Landlord as additional insureds. Tenant's policies described in Subsections 1 (iii) and (iv) above shall each contain a waiver by the insurer of any right to subrogation against Landlord, its agents, employees, contractors and representatives which arises or might arise by reason of any payment under the policy or by reason of any act or omission of Landlord, its agents, employees, contractors or representatives. All of Tenant's policies shall contain a provision that the insurer will not cancel or change the coverage provided by the policy without first endeavoring to give Landlord thirty (30) days prior written notice, except ten (10) days with respect to the non-payment of premium. Tenant shall also name Landlord as an additional insured on any excess or umbrella liability insurance policy carried by Tenant, if necessary to comply with the limits required by this Exhibit D.

**NOTICE TO TENANT: IN ACCORDANCE WITH THE TERMS OF THIS LEASE, TENANT MUST PROVIDE EVIDENCE OF THE REQUIRED INSURANCE TO LANDLORD'S MANAGEMENT AGENT PRIOR TO BEING AFFORDED ACCESS TO THE PREMISES.**

---

**EXHIBIT E**

**RULES AND REGULATIONS**

The following Rules and Regulations shall be in effect at the Building. Landlord reserves the right to adopt reasonable nondiscriminatory modifications and additions at any time. In the case of any conflict between these regulations and the Lease, the Lease shall be controlling.

1. The sidewalks, halls, passages, elevators, stairways, and other common areas shall not be obstructed by Tenant or used by it for storage, for depositing items, or for any purpose other than for ingress to and egress from the Premises. Should Tenant have access to any balcony or patio area, Tenant shall not place any furniture other personal property in such area without the prior written approval of Landlord. Nothing contained in this Lease shall be construed to prevent access to persons with whom Tenant normally deals only for the purpose of conducting its business on the Premises (such as clients, customers, office suppliers and equipment vendors and the like) unless those persons are engaged in illegal activities.

2. Except as expressly permitted in the Lease, neither Tenant nor any employee or contractor of Tenant shall go upon the roof of the Building without the prior written consent of Landlord.

3. Tenant shall, at its expense, be required to utilize the third party contractor designated by Landlord for the Building to provide any telephone wiring services from the minimum point of entry of the telephone cable in the Building to the Premises. Notwithstanding the foregoing, Tenant shall be permitted to use its own third party contractor approved in writing by Landlord (which approval shall not be unreasonably withheld, conditioned or delayed), provided Landlord's designated contractor, at Landlord's cost, may peer review all such work performed and Tenant shall not be charged any supervision fee in connection with any such work undertaken by Tenant; provided, further, Landlord hereby pre-approves Pinnacle as Tenant's third party contractor to provide telephone wiring services from the minimum point of entry to the Premises.

4. No antenna or satellite dish shall be installed by Tenant without the prior written agreement of Landlord.

5. The sashes, sash doors, windows, glass lights, solar film and/or screen, and any lights or skylights that reflect or admit light into the halls or other places of the Building shall not be covered or obstructed. If Landlord, by a notice in writing to Tenant, shall object to any curtain, blind, tinting, shade or screen attached to, or hung in, or used in connection with, any window or door of the Premises, the use of that curtain, blind, tinting, shade or screen shall be immediately discontinued and removed by Tenant. No awnings shall be permitted on any part of the Premises.

6. The installation and location of any unusually heavy equipment in the Premises, including without limitation file storage units, safes and electronic data processing equipment, shall require the prior written approval of Landlord (which shall not be unreasonably withheld). The moving of large or heavy objects shall occur only between those hours as may be reasonably designated by, and only upon previous notice to, Landlord. No freight, furniture or bulky matter of any description shall be received into or moved out of the lobby of the Building or carried in any elevator other than the freight elevator (if available) designated by Landlord unless approved in writing by Landlord.

7. Any pipes or tubing used by Tenant to transmit water to an appliance or device in the Premises must be made of copper or stainless steel, and in no event shall plastic tubing be used for that purpose.

8. Tenant shall not place any lock(s) on any door in the Premises or Building without Landlord's prior written consent, which consent shall not be unreasonably withheld. Upon the termination of its tenancy, Tenant shall deliver to Landlord all the keys to offices, rooms and toilet rooms and all access cards then in Tenant's possession.

9. Except as expressly set forth in the Lease, Tenant shall not install equipment requiring electrical or air conditioning service in excess of that to be provided by Landlord under the Lease without prior written approval from Landlord (which shall not be unreasonably withheld).

10. Tenant shall not use space heaters within the Premises.

11. Tenant shall not do or permit anything to be done in the Premises, or bring or keep anything in the Premises, which shall in any way increase the insurance on the Building, or on the property kept in the Building, or interfere with the rights of other tenants, or conflict with any government rule or regulation.

12. Tenant shall not use or keep any foul or noxious gas or substance in the Premises.

13. Tenant shall not permit the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Building by reason of noise, odors and/or vibrations, or interfere in any way with other tenants or those having business with other tenants.

---

14. Tenant shall not permit any animals or birds be kept by Tenant in or about the Building (other than service animals).

15. Neither Tenant nor its employees, agents, contractors, invitees or licensees shall bring any firearm, whether loaded or unloaded, into the Project at any time (other than police or other law enforcement personnel in the course of their duties).

16. Smoking anywhere within the Premises or Building is strictly prohibited, and Landlord may enforce such prohibition pursuant to Landlord's leasehold remedies. Smoking is permitted outside the Building and within the project only in areas designated by Landlord.

17. Tenant shall not install an aquarium of any size in the Premises unless otherwise approved by Landlord (which shall not be unreasonably withheld).

18. Tenant shall not utilize any name selected by Landlord from time to time for the Building and/or the Project as any part of Tenant's corporate or trade name. Landlord shall have the right to change the name, number or designation of the Building or Project without liability to Tenant. Tenant shall not use any picture of the Building in its advertising, stationery or in any other manner.

19. Tenant shall, upon written request by Landlord, supply Landlord with the names and telephone numbers of personnel designated by Tenant to be contacted on an after-hours basis should circumstances warrant.

20. Landlord may from time to time grant tenants individual and temporary variances from these Rules, provided that any variance does not have a material adverse effect on the use and enjoyment of the Premises by Tenant.

## EXHIBIT F

### PARKING

The following parking regulations shall be in effect at the Building In the case of any conflict between these regulations and the Lease, the Lease shall be controlling.

1. Landlord agrees to maintain, or cause to be maintained, an automobile parking area ("**Parking Area**") in reasonable proximity to the Building for the benefit and use of the visitors and patrons and, except as otherwise provided, employees of Tenant, and other tenants and occupants of the Building. Landlord shall have the right to determine the nature and extent of the automobile Parking Area, and of making such changes to the Parking Area from time to time which in its reasonable opinion are desirable and for the best interests of all persons using the Parking Area; provided that the number of parking passes allocated to Tenant pursuant to Item 11 of the Basic Lease Provisions are not reduced as a result thereof and such Parking Area complies with applicable laws, statutes, codes, regulations and ordinances. Landlord shall keep the Parking Area in a neat, clean and orderly condition, and shall repair any damage to its facilities. Except as expressly provided in Section 10.3(b) of this Lease, Landlord shall not be liable for any damage to motor vehicles of visitors or employees, for any loss of property from within those motor vehicles, or for any injury to Tenant, its visitors or employees, unless ultimately determined to be caused by the sole active negligence or willful misconduct of Landlord. Landlord shall also have the right to establish, and from time to time amend, and to enforce against all users of the Parking Area all reasonable and non-discriminatory rules and regulations (including the designation of areas for employee parking) as Landlord may reasonably deem necessary and advisable for the proper and efficient operation and maintenance of the Parking Area.

2. Subject to Paragraph 4 below, Landlord may, if it deems advisable in its sole discretion, charge for parking and may establish for the Parking Area a system or systems of permit parking for Tenant, its employees and its visitors. In no event shall Tenant or its employees park in reserved stalls leased to other tenants or in stalls within designated visitor parking zones, nor shall Tenant or its employees utilize more than the number of Parking Passes (defined below) allotted in this Lease to Tenant. Tenant shall, upon request of Landlord from time to time, furnish Landlord with a list of its employees' names and of Tenant's and its employees' vehicle license numbers. Parking access devices, if applicable, shall not be transferable. Landlord may impose a reasonable fee for access devices and a replacement charge for devices which are lost or stolen. Each access device shall be returned to Landlord promptly following the Expiration Date or sooner termination of this Lease.

3. Washing, waxing, cleaning or servicing of vehicles, or the parking of any vehicle on an overnight basis, in the Parking Area (other than emergency services) by any parker or his or her agents or employees is prohibited unless otherwise authorized by Landlord.

4. It is understood that the employees of Tenant and the other tenants of Landlord within the Building and Project shall not be permitted to park their automobiles in the portions of the Parking Area which may from time to time be designated for patrons of the Building and/or Project. Tenant may purchase all or a portion of the parking passes for unreserved parking set forth in Item 11 of the Basic Lease Provisions (the "**Parking Passes**"), at the monthly scheduled rates as Landlord shall from time to time reasonably determine. Landlord agrees that Tenant may convert up to 5 of the Parking Passes to reserved stalls, at Landlord's scheduled asking rate from time to time, by providing written notice of such election to Landlord within one hundred eighty (180) days following the Commencement Date (the "**Converted Stalls**"). Tenant acknowledges that if such written notice of election is not delivered to Landlord within such one hundred eighty (180) day period, then the conversion of the Parking Passes to reserved stalls shall be subject to the month to month availability of such reserved stalls as determined by Landlord. In addition, during the initial 62 month Lease Term only, and provided Tenant is not in Default under this Lease, Tenant shall have the right to purchase visitor parking validations for its own use only at a cost which is reduced by 20% from the rate that Landlord is actually charging for visitor parking from time to time. Should any monthly parking charge not be paid within 5 business days following written notice to Tenant that the same is past due, then a late charge shall be payable by Tenant equal to 5% of the delinquent installment, which late charge shall be separate and in addition to any late charge that may be assessed pursuant to Section 14.3 of the Lease for other than delinquent monthly parking charges. During the initial twelve (12) months of the Lease Term ("**Parking Credit Period**"), Tenant shall be entitled to a credit in the amount of \$164,736.00 ("**Parking Credit**") to be applied to the cost of Parking Passes, including any Converted Stalls. The Parking Credit shall be automatically applied to parking charges incurred by Tenant during the Parking Credit Period. Any portion of the Parking Credit not used by the end of the Parking Credit Period shall be forfeited by Tenant.

5. Landlord shall be entitled to pass on to Tenant its proportionate share of any charges or parking surcharge or transportation management costs levied by any governmental agency (provided, however, under no circumstances shall Tenant, during the initial twelve (12) months of the Term, be charged for any fees related to unreserved stalls) and Tenant shall use commercially reasonable efforts to cooperate in mandatory transportation management programs.

6. Tenant shall not assign or sublet any of the Parking Passes, either voluntarily or by operation of law, without the prior written consent of Landlord, except in connection with an authorized assignment of this Lease or subletting of the Premises.

EXHIBIT G

ADDITIONAL PROVISIONS

**1. RIGHT(S) TO EXTEND THIS LEASE.** Provided that Tenant is not in Default under any provision of this Lease at the time of exercise of the extension right granted herein, and provided further that Tenant has not assigned its interest in this Lease (except in connection with an assignment of this Lease to an Affiliate as described in Section 9.1(e) hereof), nor sublet more than forty percent (40%) of the Premises in the aggregate (except to an Affiliate), Tenant may extend the Term of this Lease for 2 consecutive periods of 36 months each. Tenant shall exercise its right to extend the Term by and only by delivering to Landlord, not less than 9 months nor more than 12 months prior to the then-current expiration date of the Term, Tenant's written notice of its irrevocable commitment to extend (the "**Commitment Notice**"). The Basic Rent payable and other economic terms under the Lease during any extension of the Term shall be determined as provided in the following provisions.

Following Landlord's receipt of Tenant's Commitment Notice, Landlord and Tenant shall endeavor to reach agreement upon the Basic Rent and other economic terms that would reflect the Fair Market Rental (as defined below) for each thirty-six (36) month renewal of the Lease (together with any increases thereof during the extension period). If Landlord and Tenant have not by then been able to agree upon the Basic Rent and other economic terms for the extension of the Term, then not later than one hundred twenty (120) days prior to the then applicable expiration date of the Term, Landlord shall notify Tenant in writing of the Basic Rent and other economic terms that would reflect the prevailing market rental rate (the "**Fair Market Rental**" herein) for a thirty-six (36) month renewal of the Lease (together with any increases thereof during the extension period) as of the commencement of the extension period taking into consideration "**Comparable Spaces**" (defined below) ("**Landlord's Determination**"). Should Tenant disagree with the Landlord's Determination, then Tenant shall, not later than twenty (20) days thereafter, notify Landlord in writing of Basic Rent and other economic terms that would reflect the Fair Market Rental for a thirty-six (36) month renewal of the Lease (together with any increases thereof during the extension period) ("**Tenant's Determination**"). Within ten (10) days following delivery of the Tenant's Determination, the parties shall attempt to agree on an appraiser to determine the Fair Market Rental. If the parties are unable to agree in that time, then each party shall designate an appraiser within ten (10) days thereafter. Should either party fail to so designate an appraiser within that time, then the appraiser designated by the other party shall determine the Fair Market Rental. Should each of the parties timely designate an appraiser, then the two appraisers so designated shall appoint a third appraiser not previously employed (or designated for a similar market rental determination) by either Landlord or Tenant, who shall, acting alone, determine whether Landlord's Determination or Tenant's Determination better reflects the Fair Market Rental for the extension period. Any appraiser designated hereunder shall have an M.A.I. certification with not less than five (5) years experience in the valuation of commercial office buildings in the vicinity of the Project.

Within thirty (30) days following the selection of the third appraiser and such third appraiser's receipt of the Landlord's Determination and the Tenant's Determination, the third appraiser shall determine whether the Landlord's Determination or the Tenant's Determination better reflects the Fair Market Rental for the thirty-six (36) month renewal of the Lease for the Premises, as reasonably extrapolated to the commencement of the extension period. Accordingly, either the Landlord's Determination or the Tenant's Determination shall be selected by the third appraiser as the Fair Market Rental for the extension period. In making such determination of Fair Market Rental, the appraiser shall consider rental comparables for comparable spaces in terms of size ("**Comparable Spaces**"), involving similarly improved space in the vicinity of the Project with appropriate adjustments for differences in location and quality of project including factors then being granted in connection with lease renewals and new transactions in Comparable Spaces, including factors for market tenant improvements and/or allowances; rental abatement concessions; base year and/or expense stop or similar operating expense protections; the amount, cost and type of parking; and all other monetary and non-monetary concessions; provided, however, that notwithstanding any contrary provisions of this Section, no consideration shall be given by the final appraiser to the fact that Landlord is or is not required to pay a real estate brokerage commission in connection with the extension period or whether any comparable transaction relied upon by the final appraiser in determining the Fair Market Rental included the payment of a real estate brokerage commission. At any time before the decision of the appraiser is rendered, either party may, by written notice to the other party, accept the rental terms submitted by the other party, in which event such terms shall be deemed adopted as the agreed Fair Market Rental. The fees of the third appraiser shall be borne entirely by the party whose determination of the Fair Market Rental was not accepted by the third appraiser.

Within twenty (20) days after the determination of the Fair Market Rental, Landlord shall prepare an appropriate and accurate amendment to this Lease for the extension period in form reasonably satisfactory to Tenant, and Tenant shall execute and return same to Landlord within ten (10) business days after Tenant's receipt of same. In the event that Tenant has any objections to the form of such amendment, Tenant shall provide such objections in writing within ten (10) business days after Tenant's receipt of the proposed amendment, and Landlord and Tenant shall thereafter work together in good faith to timely execute an amendment in form reasonably satisfactory to Tenant, provided that the delay in execution of any such amendment, or any failure to execute such amendment shall not affect the validity of Tenant's exercise of its right to extend the Term, nor the final appraiser's determination of the Fair Market Rental for the Premises for the extension period. Should the readjusted Fair Market Rental not be established by the commencement of the extension period, then Tenant shall continue paying Basic Rent

at the rate in effect during the last month of the initial Term, and a lump sum adjustment shall be made within thirty (30) days after the determination of such adjusted Basic Rent.

If Tenant fails to timely exercise the extension right granted herein within the time period expressly set forth for exercise by Tenant in the initial paragraph of this Section, Tenant's right to extend the Term shall be extinguished and the Lease shall automatically terminate as of the expiration date of the Term, without any extension and without any liability to Landlord. Any attempted assignment or transfer of such rights (except by way of a "**Permitted Transfer**") shall be void and of no force and effect. Tenant shall have no other right to extend the Term beyond the 2 36 month extensions created by this Section. Unless agreed to in a writing signed by Landlord and Tenant, any extension of the Term, whether created by an amendment to this Lease or by a holdover of the Premises by Tenant, or otherwise, shall be deemed a part of, and not in addition to, any duly exercised extension period permitted by this Section. Time is specifically made of the essence in this Section.

**2. RIGHT OF FIRST OFFER.** Provided Tenant is not then in Default hereunder, and provided Tenant has not exercised its termination right under Paragraph 3 of this **Exhibit G**, Landlord hereby grants Tenant the continuing right ("**First Right**") to lease, during the initial 62 month Term of this Lease, any office space contiguous to the Premises ("**First Right Space**") in accordance with and subject to the provisions of this Section. Except as otherwise provided below, prior to leasing the First Right Space, or any portion thereof, to any other party during the period that this First Right is in effect, Landlord shall give Tenant written notice of the basic economic terms including but not limited to the Basic Rent, term, operating expense base, security deposit, and tenant improvement allowance (collectively, the "**Economic Terms**"), upon which Landlord is willing to lease such particular First Right Space to Tenant or to a third party; provided that the Economic Terms shall exclude brokerage commissions and other Landlord payments that do not directly inure to the tenant's benefit. It is understood that should Landlord intend to lease other office space in addition to the First Right Space as part of a single transaction, then Landlord's notice shall so provide and all such space shall collectively be subject to the following provisions. Within 5 business days after receipt of Landlord's notice, Tenant must give Landlord written notice pursuant to which Tenant shall elect to (i) lease all, but not less than all, of the space specified in Landlord's notice (the "**Designated Space**") upon such Economic Terms and the same non-Economic Terms as set forth in this Lease; (ii) refuse to lease the Designated Space, specifying that such refusal is not based upon the Economic Terms, but upon Tenant's lack of need for the Designated Space, in which event Landlord may lease the Designated Space upon any terms it deems appropriate; or (iii) refuse to lease the Designated Space, specifying that such refusal is based upon said Economic Terms, in which event Tenant shall also specify revised Economic Terms upon which Tenant shall be willing to lease the Designated Space. In the event that Tenant does not so respond in writing to Landlord's notice within said period, Tenant shall be deemed to have elected clause (ii) above. In the event Tenant gives Landlord notice pursuant to clause (iii) above, Landlord may elect to either (x) lease the Designated Space to Tenant upon such revised Economic Terms and the same other non-Economic Terms as set forth in this Lease, or (y) lease the Designated Space to any third party upon Economic Terms which are not materially more favorable to such party than those Economic Terms proposed by Tenant. Should Landlord so elect to lease the Designated Space to Tenant, then Landlord shall promptly prepare and deliver to Tenant an amendment to this Lease consistent with the foregoing, and Tenant shall execute and return same to Landlord within 10 business days (or, within such time period, make reasonable revisions to the same and Tenant's failure to timely return the revised amendment shall entitle Landlord to specifically enforce Tenant's commitment to lease the Designated Space, to lease such space to a third party, and/or to pursue any other available legal remedy to Landlord). In the event that Landlord leases the First Right Space, or any portion thereof, to a third party in accordance with the provisions of this Section, and during the effective period of this First Right the First Right Space, or any portion thereof, shall again become available for releasing, then prior to Landlord entering into any such new lease with a third party for the First Right Space, Landlord shall repeat the procedures specified above in this Section. Notwithstanding the foregoing, it is understood that Tenant's First Right shall be subject to any extension or expansion rights previously granted by Landlord to any third party tenant in the Building, as well as to any such rights which may hereafter be granted by Landlord to any third party tenant now or hereafter occupying the First Right Space or any portion thereof, and Landlord shall in no event be obligated to initiate this First Right prior to leasing any portion of the First Right Space to the then-current occupant thereof. Tenant's rights under this Section shall be personal to the original Tenant named in this Lease and may not be assigned or transferred (except in connection with a Permitted Transfer of this Lease as described in Section 9.1(e) hereof). Any other attempted assignment or transfer shall be void and of no force or effect.

**3. RIGHT TO TERMINATE.** Provided (i) Tenant is not in Default under any provision of this Lease and (ii) Tenant has not exercised any expansion right and provided Tenant has not exercised any First Right pursuant to Paragraph 2 of this **Exhibit G**, Tenant shall have a one-time right to terminate this Lease effective as of the expiration of the 36<sup>th</sup> month of the initial Term. Tenant shall exercise such termination right by giving written notice thereof to Landlord (the "**Termination Notice**") at least 6 months prior to the effective date of termination. All Rent and other costs due under this Lease for the Premises shall be due and payable by Tenant to Landlord through the effective date of termination. In addition, should Tenant exercise the foregoing right to terminate, Tenant shall pay to Landlord, concurrently with its delivery of the Termination Notice, a separate termination fee, as reasonably computed by Landlord, comprised of the following: (i) the unamortized portion (based upon a constant amortization over a 5 year period with 7% interest) as of the effective date of termination of (A) brokerage commissions paid by Landlord in connection with the Lease, and (B) Landlord's Contribution funded by Landlord; plus (ii) unamortized Abated Basic Rent (i.e. based upon the amortization of the Abated Basic Rent in equal monthly amounts during the initial Term, without interest), if any. Any such termination shall not abrogate

---

any obligation existing under the Lease as of the termination date or otherwise attributable to Tenant's occupancy thereof.

---

**EXHIBIT H**  
**JANITORIAL SPECIFICATIONS**

**OFFICE AREAS:**

**Nightly Services—five (5) times per week (Sunday—Thursday)**

- Empty wastebaskets and other trash receptacles. (Exception: do not empty paper shredders.)
- All chairs and wastebaskets to be returned to proper position after cleaning.
- Vacuum all carpeted areas wall to wall. Detail vacuuming of corners and edges is performed weekly.
- Spot-clean entrance door glass and conference room glass door. (around door handles)
- Conference Room(s)- Clean table tops unless directed otherwise.
- Kitchen and Cafeteria (defined in Paragraph 8 of **Exhibit G**)—wipe down sink and counter tops, Sweep and Mop hard surface floors, empty trash.
- Spot clean carpets (size of half dollar or less).

**Weekly Services**

- Dust mop all composition floors with specially treated mops.
- Completely dust windowsills, window ledges, door louvers and wood paneling molding, handrails and railings.
- Dust vertical surfaces without moving any items and all picture frames on walls.
- Dust levelor blinds where applicable.
- Detail vacuum corners and edges of baseboards.

**Monthly Services**

- Dust all high-reach areas; door frames, door tops and partitions and vertical blinds.

**Quarterly Service**

- Strip, scrub and wax vct floors, wipe down baseboards when completed.

**Windows**

**Quarterly Service**

- Exterior windows to be cleaned once per year on the outside.

**EXHIBIT X**  
**WORK LETTER**

**I. TENANT IMPROVEMENTS**

The tenant improvement work ("**Tenant Improvements**") shall consist of any work required to complete the Premises pursuant to approved plans and specifications as set forth herein. Tenant shall employ its own architect and general contractor in constructing the Tenant Improvements. The general contractor shall be selected and engaged by Tenant on the basis of a competitive bid involving one general contractor designated by Landlord and up to 2 other general contractors approved in writing by Landlord, which approval shall not be unreasonably withheld or conditioned and Landlord's approval shall be granted or denied (with detailed reasons given for any denial) within five (5) business days following Tenant's written request. Tenant shall have the right to select the contractor to perform the Tenant Improvements following receipt of the bids. Landlord, at Landlord's sole cost and expense shall deliver the Premises to Tenant clean and free and clear of all phone and data cabling, debris and personal property with the Building and Common Areas (which shall include the existing restrooms on the floors where the Premises is located) and all Building systems and equipment serving the Premises (including without limitation, HVAC, lighting, electrical, elevator and plumbing) in good working order and compliance with applicable laws. The Tenant Improvements shall be undertaken and prosecuted in accordance with the following requirements:

- A. Concurrently with sign-off by Tenant, the space plans, construction drawings and specifications for all improvements and finishes, together with any changes thereto, shall be submitted to Landlord (with samples as reasonably required) for review and reasonable approval by Landlord and its architect for the Project within five (5) business days of written request. Should Landlord approve work that would necessitate any ancillary Building modification or other expenditure by Landlord which is not Landlord's obligation under the Lease or this Work Letter, then except to the extent of any remaining balance of the "Landlord Contribution" as described below, Tenant shall, in addition to its other obligations herein, promptly fund the cost thereof.
- B. All construction drawings prepared by Tenant's architect shall follow Landlord's commercially reasonable CAD standards, which standards shall be provided to Tenant or its architect on or before the mutual execution of this Lease.
- C. Landlord shall, subject to the foregoing, reasonably approve or disapprove any submittal of detailed plans (i.e., a detailed pricing plan) or specifications by Tenant ("**Plans**") within five (5) business days following receipt thereof by Landlord. Landlord shall, within five (5) business days after Landlord's receipt of the Plans, either (i) approve the Plans, (ii) approve the Plans subject to specified conditions which must be stated in a reasonably clear and complete manner to be satisfied by Tenant prior to obtaining permits to the extent the Plans contain a Design Problem, or (iii) disapprove and return the Plans to Tenant with requested revisions to the extent the Plans contain a Design Problem. If Landlord disapproves the Plans, Tenant may resubmit the Plans to Landlord at any time, and Landlord shall approve or disapprove the resubmitted Plans, based upon the criteria set forth in this Section, within three (3) business days after Landlord receives such resubmitted Plans. Such procedure shall be repeated until the Plans are approved. If Landlord fails to respond to such request for approval within such period, Tenant may deliver a written "reminder notice", informing Landlord that it has failed to respond, and warning that a continued failure may result in a "deemed approval". If Landlord fails to respond to such "reminder notice" within three (3) business days, then Landlord shall be deemed to have approved the submitted Plans. A "**Design Problem**" is defined as, and will be deemed to exist if it will (i) adversely affect the exterior appearance of the Building; (ii) adversely affect the Building structure; (iii) adversely affect the Building systems in a non-de minimus manner; (iv) unreasonably interfere with any other occupant's normal and customary office operation; or (v) fail to comply with applicable laws; provided, however, notwithstanding that the following improvements might otherwise constitute a Design Problem (file rooms, server room and UPS unit(s)), Landlord shall not unreasonably withhold its consent to such improvements. In the event Tenant desires to change the Plans, Tenant shall deliver notice (the "**Drawing Change Notice**") of the same to Landlord, setting forth in detail the changes (the "**Tenant Change**") Tenant desires to make to the Plans. Landlord shall, within five (5) business days of receipt of a Drawing Change Notice related to a Tenant Change affecting the base building or base systems, and within three (3) business days of receipt of the Drawing Change Notice related to a Tenant Change which does not affect the base building or base systems, either (i) approve the Tenant Change, or (ii) disapprove the Tenant Change and deliver a notice to Tenant specifying in reasonably sufficient detail the reasons for Landlord's reasonable disapproval provided Landlord shall not disapprove of any Tenant Change which is reasonably consistent with the Plans. Any additional costs which arise in connection with such Tenant Change shall be paid by Tenant pursuant to this Work Letter; provided, however, that to the extent the Landlord Contribution has not been fully

disbursed, such payment shall be made out of the Landlord Contribution subject to the terms of this Work Letter.

- D. Subject to the terms herein, Tenant may use the electrical, mechanical, and plumbing engineers and subcontractors designated by Landlord. Should Tenant elect not to utilize such electrical, mechanical, plumbing engineers and subcontractors designated by Landlord, then Tenant's preliminary and final drawings shall be subject to a reasonable peer-review by Landlord's architect. Such costs, including the peer review fee (which such fee in the aggregate shall not exceed Three Thousand Dollars (\$3,000.00)), shall be deducted from the Landlord Contribution (defined below). Tenant shall use the fire/life safety engineers and subcontractors designated by Landlord so long as such engineers and contractors are reasonably available and competitively priced. All other subcontractors shall be subject to Landlord's reasonable approval, and Landlord may require that one or more designated subtrades be union contractors which shall be granted or denied within five (5) business days and Landlord requires that the drywall and acoustical subtrades be union contractors but no other trades shall be required to be union. In addition, Tenant may engage its own project manager to oversee the Tenant Improvements and such costs may be deducted from the Landlord Contribution, as evidenced by invoices submitted to Landlord.
- E. Tenant shall deliver to Landlord a copy of the final application for permit and issued permit for the Tenant Improvements; provided, however, that Landlord shall cooperate with Tenant in executing permit applications and performing other ministerial acts reasonably necessary to enable Tenant to obtain any such permit or certificate of occupancy.
- F. Tenant's general contractor and each of its subcontractors shall comply with Landlord's commercially reasonable requirements as generally imposed on third party contractors, including without limitation all insurance coverage requirements and the obligation to furnish appropriate certificates of insurance to Landlord prior to commencement of construction.
- G. A construction schedule shall be provided to Landlord prior to commencement of the construction work, and weekly updates, if required by Landlord, shall be supplied during the progress of the work.
- H. Tenant shall give Landlord ten (10) days prior written notice of the commencement of construction so that Landlord may cause an appropriate notice of non-responsibility to be posted.
- I. Tenant's general contractor shall attend job meetings as requested with Landlord's construction manager for the Project but no more than one time per week (and Tenant shall be available by phone).
- J. Upon completion of the Tenant Improvements, Tenant shall cause to be provided to Landlord (i) as-built drawings of the Premises signed by Tenant's architect, (ii) CAD files of the improved space compatible with Landlord's CAD commercially reasonable standards, (iii) a final punchlist signed by Tenant, (iv) final and unconditional lien waivers from all contractors and subcontractors, (v) a duly recorded Notice of Completion of the Tenant Improvements, and (vi) a certificate of occupancy for the Premises or its legal equivalent (collectively, the "**Close-out Package**"). Should Tenant fail to provide complete CAD files compatible with Landlord's reasonable standards as required herein within thirty (30) days of completion of the Tenant Improvements, Landlord may cause its architect to prepare same and the cost thereof shall be reimbursed to Landlord by Tenant within thirty (30) days of invoice therefor.
- K. The Tenant Improvements shall be prosecuted at all times in accordance with all state, federal and local laws, regulations and ordinances, including without limitation all OSHA and other safety laws.
- L. All of the provisions of this Lease shall apply to any activity of Landlord and Tenant and their agents and contractors, in the Premises prior to the Commencement Date, except for the obligation of Tenant to pay rent.

Landlord shall not be liable in any way for any injury, loss or damage which may occur to any work performed by Tenant, nor shall Landlord be responsible for repairing any defective condition therein. In no event shall Tenant's failure to complete the Tenant Improvements extend the Commencement Date of the Lease.

## II. COST OF THE WORK

- A. Landlord shall provide to Tenant a tenant improvement allowance in the amount of \$696,517.00 (the “**Landlord Contribution**”) which can be used towards the design and construction costs (including without limitation, payment of the fees of the architect and engineers, the payment of plan check, permit and license fees, the cost of construction of the Tenant Improvements, including, without limitation, testing and inspection costs, freight elevator usage, window treatments (which shall be Building standard), Tenant’s HVAC System, hoisting and trash removal costs and security systems, equipment installation and relocation costs relating to such installation to the Premises, contractors’ fees and general conditions, sales and use taxes and Title 24 fees, gross receipts taxes and any other taxes imposed on or pertaining to the Tenant Improvements), with any excess cost to be borne solely by Tenant. The Landlord Contribution may also be utilized to fund space planning, project management and other architectural and engineered costs (including the reasonable cost charged by Landlord’s architect to review Tenant’s drawings and CAD files, construction costs and plan check and permit fees. Landlord shall not be entitled to a supervision/administrative fee in connection with the Tenant Improvements. Tenant understands and agrees that any portion of the Landlord Contribution not requested by Tenant in accordance with this **Exhibit X** by June 30, 2014, shall inure to the benefit of Landlord and Tenant shall not be entitled to any credit or payment; provided, however, that Tenant may, upon written request delivered to Landlord not later than June 30, 2014, apply up to \$109,753.00 of the unused Landlord Contribution to the next then due Basic Rent. Landlord and Tenant shall memorialize any such reduction in the Basic Rent on a form provided by Landlord. Landlord shall reimburse Tenant in one installment within 30 days following receipt of all such invoices. Notwithstanding the foregoing, Tenant may utilize all or a portion of the unused Landlord Contribution toward (i) data/telephone cabling and wireless, (ii) security equipment (access control, alarm and CCTV) and cabling, (iii) signage and graphics installed in the Premises, and (iv) the out-of-pocket moving expenses incurred by Tenant for relocating to the Premises, including moving costs, furniture and auxiliary equipment required for the operation of Tenant’s business, such as additional HVAC. Tenant shall be reimbursed for such expenses by submitting copies of all supporting third-party invoices to Landlord by December 31, 2013.
- B. Landlord shall fund the Landlord Contribution (less deductions for the above-described supervision fee and peer review fee, if any) in installments as and when costs are incurred and a payment request therefor is submitted by Tenant. Each payment request shall include a copy of all supporting invoices, conditional progress payment lien waivers (in the form prescribed by the California Civil Code) for labor and materials incorporated in such payment request, unconditional lien waivers (in the form prescribed by the California Civil Code) for labor and materials on the basis of which payment has previously been by Landlord, and pertinent back-up (including copies of Tenant’s payment checks to its contractors and suppliers). Landlord shall fund the payment request within 30 days following receipt of the application and supporting materials; provided that a 10% retention shall be held on payments to Tenant’s contractor (but not for Tenant’s architect, project manager and similar consultants) until Landlord receives the complete Close-out Package. The remaining balance of the Landlord Contribution shall be funded within 30 days of Landlord’s receipt of the complete Close-out Package. Prior to any payment by Landlord hereunder, Tenant shall provide to Landlord in writing the address to which such payment is to be delivered, together with a complete copy of the construction contract(s) for the Tenant Improvements.
- C. Neither the architect, contractor, the engineers nor Tenant’s agents shall be charged for the use of the freight elevators, loading docks, restrooms, parking facilities or utilities during the design and construction of the Tenant Improvements or Tenant’s move into the Premises. Landlord shall not supply and Tenant shall not be charged for Building security in connection with the construction of the Tenant Improvements. Landlord shall, consistent with its obligations to other tenants of the Building, make the freight elevator reasonably available to Tenant in connection with initial decorating, furnishing and moving into the Premises. In the event that during the installation of the Tenant Improvements, the Premises are determined to contain hazardous materials, that were not brought on to the Premises by Tenant, Landlord, at its sole cost and expense, shall remove, encapsulate, contain, or otherwise dispose of such hazardous materials in accordance with laws, and, so long as Tenant promptly notifies Landlord upon discovery, any delay resulting therefrom shall be a Commencement Date Delay only if it actually delays the Commencement Date. Notwithstanding anything to the contrary set forth in this Lease, Tenant shall not be required to obtain or provide any completion or performance bond in connection with any Tenant Improvements performed by or on behalf of Tenant.

III. DELAY OF COMMENCEMENT DATE.

The Commencement Date shall occur as provided in Section 3 of the Lease, provided that the Commencement Date shall be extended by the number of days of delay of the Substantial Completion of the Tenant Improvements and/or Tenant’s move into the Premises to the extent caused by a Commencement Date Delay (as that term is defined below). As used herein, the term “**Commencement Date Delay**” shall mean only a Force Majeure Delay or a Landlord

Caused Delay (as those terms are defined below). As used herein, the term "**Force Majeure Delay**" shall mean only an actual delay resulting from fire, wind, damage or destruction to the Building, explosion, casualty, flood, hurricane, tornado, the elements, acts of God or the public enemy, strikes, sabotage, war, invasion, insurrection, rebellion, civil unrest, riots, or earthquakes, failure of utilities, inability to secure permits and governmental inspections beyond the time period that would normally be required to secure such permits and inspections on an objective basis by any other person or entity constructing improvements comparable to the Tenant Improvements and so long as Tenant is diligently pursuing such permits and inspections. As used in this Work Letter, "**Landlord Caused Delay**" shall mean an actual delay in the Substantial Completion of the Tenant Improvements to the extent resulting from the acts or omissions of Landlord or its agents, employees or contractors ("**Landlord Parties**"), including without limitation, (i) Landlord's failure to deliver possession of the Premises on or prior to February 15, 2013; (ii) except to the extent Landlord's approval under this Work Letter is deemed granted pursuant to the terms of this Work Letter, Landlord's failure to timely approve any matter requiring Landlord's approval in this Work Letter within the time periods set forth in this Work Letter or this Lease, as applicable, or otherwise within a reasonable period of time; (iii) Landlord's failure to timely disburse the Landlord Contribution or comply with any other provisions of this Work Letter; (iv) material and unreasonable interference by Landlord or the Landlord Parties (except as otherwise allowed under this Work Letter) with substantial completion of the Tenant Improvements if such interference (A) objectively precludes or delays the construction of general office use Tenant Improvements in the Building or any portion thereof (provided that "noisy work" may have to be performed during non-business hours and shall not constitute a Landlord Caused Delay), and (B) relates to access by Tenant or Tenant's Parties to the Premises or any of the Building's facilities (including loading docks and freight elevators) or services and utilities (including temporary power and parking areas as provided herein) during normal construction hours, or the use thereof during normal construction hours; (v) Landlord's failure to deliver the Premises, Building, Common Areas, base building and base systems in substantially the condition required; or (vi) the negligence or willful misconduct of Landlord or the Landlord Parties. For purposes of this Work Letter, "**Substantial Completion**" of the Tenant Improvements shall mean (i) the issuance of a temporary certificate of occupancy or its equivalent for the Premises and substantial completion of construction of the Tenant Improvements in the Premises pursuant to the Plans, including any furniture, fixtures, work stations, built-in furniture or equipment necessary to obtain a temporary certificate of occupancy or its equivalent, with the exception of any punch list items, and (ii) the operation all building services and parking required to be provided by Landlord under this Lease.

IV. TENANT TERMINATION RIGHT.

In the event Landlord fails to deliver possession of the Premises to Tenant for the commencement of the Tenant Improvements by March 15, 2013 (the "**Outside Delivery Date**"), Tenant, as its sole remedy, may terminate this Lease by giving written notice to Landlord within 5 business days following the Outside Delivery Date. In such event, this Lease shall be deemed null and void and of no further force and effect.

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 333-129819, 333-144441 and 333-156838) pertaining to the 2004 Share Option Scheme, the 2000 Executive Share Option Scheme and the 2007 Omnibus Incentive Plan of Spark Networks, Inc. of our report dated March 8, 2013, with respect to the consolidated financial statements of Spark Networks, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2012.

/s/ Ernst & Young LLP

Los Angeles, California  
March 8, 2013

## CERTIFICATION

I, Gregory R. Liberman, certify that:

1. I have reviewed this annual report on Form 10-K of Spark Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Gregory R. Liberman

---

Gregory R. Liberman  
Chief Executive Officer  
March 8, 2013

## CERTIFICATION

I, Brett A. Zane, certify that:

1. I have reviewed this annual report on Form 10-K of Spark Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Brett A. Zane

---

Brett A. Zane  
Chief Financial Officer  
March 8, 2013

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of Spark Networks, Inc. (the "Company") on Form 10-K for the period ending December 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned, in the capacities and on the dates indicated below, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gregory R. Liberman

Gregory R. Liberman  
Chief Executive Officer  
March 8, 2013

/s/ Brett A. Zane

Brett A. Zane  
Chief Financial Officer  
March 8, 2013