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SPARK NETWORKS INC
Form 10-Q
August 08, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

OR

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

For the transition period from _____ to _____

Commission file number: 001-32750

SPARK NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

20-8901733

(I.R.S. Employer Identification No.)

11150 Santa Monica Boulevard, Suite 600

Los Angeles, California

(Address of principal executive offices)

90025

(Zip Code)

(310) 893-0550

(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a small reporting company)

Smaller reporting company

Emerging growth company

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

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

The registrant had 32,176,023 shares of common stock, par value \$0.001 per share, outstanding as of August 2, 2017.

SPARK NETWORKS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

SPARK NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands, except share data)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$9,808	\$ 11,360
Restricted cash	380	454
Accounts receivable	438	525
Prepaid expenses and other	540	1,408
Total current assets	11,166	13,747
Property and equipment, net	2,221	4,494
Goodwill	11,136	10,523
Intangible assets, net	2,840	2,950
Deposits and other assets	90	103
Total assets	\$27,453	\$ 31,817
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$1,158	\$ 819
Accrued liabilities	2,858	2,590
Deferred revenue	3,143	4,005
Total current liabilities	7,159	7,414
Deferred tax liability - non-current	2,274	2,092
Other liabilities	98	246
Total liabilities	9,531	9,752
Commitments and Contingencies (Note 10)		
Stockholders' equity:		
10,000,000 shares of Preferred Stock authorized, \$0.001 par value, 450,000 of which are designated as Series C Junior Participating Cumulative Preferred Stock, with no shares of Preferred Stock issued or outstanding	-	-
100,000,000 shares of Common Stock authorized, \$0.001 par value, with 32,176,023 and 31,983,545 shares of Common Stock issued and outstanding at June 30, 2017 and December 31, 2016:	32	32
Additional paid-in-capital	87,543	87,198
Accumulated other comprehensive income	869	713
Accumulated deficit	(70,522)	(65,878)
Total stockholders' equity	17,922	22,065
Total liabilities and stockholders' equity	\$27,453	\$ 31,817

See accompanying notes

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(unaudited, in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Revenue	\$6,640	\$9,098	\$13,904	\$18,957
Cost and expenses:				
Cost of revenue (exclusive of depreciation shown separately below)	1,684	2,653	4,038	8,882
Sales and marketing	561	1,380	1,211	2,832
Customer service	586	840	1,221	1,833
Technical operations	280	305	499	602
Development	904	1,180	1,619	2,210
General and administrative	3,664	2,004	6,898	4,515
Depreciation	1,666	746	3,374	1,458
Amortization of intangible assets	49	78	98	156
Impairment of intangible and long-lived assets	15	52	24	91
Total cost and expenses	9,409	9,238	18,982	22,579
Operating loss	(2,769)	(140)	(5,078)	(3,622)
Interest (income) expense and other, net	(111)	114	(342)	(27)
Loss before income tax benefit	(2,658)	(254)	(4,736)	(3,595)
Income tax benefit	(139)	(583)	(92)	(516)
Net (loss) income	(2,519)	329	(4,644)	(3,079)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustment	56	(4)	156	(25)
Comprehensive (loss) income	\$(2,463)	\$325	\$(4,488)	\$(3,104)
Net (loss) earnings per share - basic and diluted	\$(0.08)	\$0.01	\$(0.14)	\$(0.12)
Weighted average shares outstanding - basic	32,098	25,908	32,051	25,885
Weighted average shares outstanding - diluted	32,098	25,975	32,051	25,885

	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Stock-based compensation				
Sales and marketing	\$15	\$67	\$16	\$95
Customer service	2	4	5	4
Technical operations	2	24	4	44
Development	16	7	12	12
General and administrative	150	242	308	511

See accompanying notes

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	For the Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net loss	\$(4,644)	\$(3,079)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	3,472	1,614
Impairment of intangible and long-lived assets	24	91
Stock-based compensation	345	666
Foreign exchange gain on intercompany loan	(423)	(64)
Provision for deferred income taxes	182	(1)
Settlement of unrecognized tax benefits	(186)	(719)
Bad debt expense	-	52
Changes in operating assets and liabilities:		
Accounts receivable	87	369
Restricted cash	74	131
Prepaid expenses and other assets	830	736
Accounts payable and accrued liabilities	858	(682)
Deferred revenue	(862)	(626)
Other liabilities	(148)	(146)
Net cash used in operating activities	(391)	(1,658)
Cash flows from investing activities:		
Purchases of property and equipment	(1,161)	(1,777)
Net cash used in investing activities	(1,161)	(1,777)
Net decrease in cash	(1,552)	(3,435)
Cash and cash equivalents at beginning of year	11,360	6,565
Cash and cash equivalents at end of year	\$9,808	\$3,130
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$37	\$14
Supplemental disclosure of non-cash investing activities:		
Purchases of property and equipment recorded in accounts payable and accrued liabilities	\$26	\$91

See accompanying notes

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. The Company and Summary of Significant Accounting Policies

The Company

Spark Networks, Inc. (the “Company” or “we”) creates communities that help individuals form life-long relationships with others that share their interests and values. The Company’s core properties, JDate and Christian Mingle, are communities geared towards singles of the Jewish and Christian faiths. Through the Company’s websites and mobile applications, the Company helps members search for and communicate with other like-minded individuals.

Our online singles properties provide users with three key services: searching for compatible individuals with whom to potentially form long-term relationships; validating compatibility through profiles, viewing photographs and understanding likes and characteristics; and communicating via one of our numerous communications platforms designed to foster relationships.

Membership on our online singles websites or mobile applications is free and allows registered members to post personal profiles and take advantage of our search and validation features. With the exception of JSwipe, which employs a “freemium” model, the ability to initiate communication with other members requires payment in the form of a monthly subscription fee. These subscription fees are 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 under the ticker symbol LOV.

Merger Agreement with Affinitas GmbH (“Elite Singles”)

On May 2, 2017, the Company entered into an Agreement and Plan of Merger by and among the Company, Affinitas GmbH, a German limited company (“Affinitas”), Blitz 17-655 SE, a European stock corporation (Societas Europaea, SE) with its corporate seat in Germany (“New Parent”), and Chardonnay Merger Sub, Inc., a Delaware corporation and a direct wholly owned subsidiary of New Parent (“Merger Sub”) (the “Merger Agreement”). The Merger Agreement provides that, upon the terms and subject to the conditions set forth therein, Merger Sub will be merged with and into the Company, and the separate existence of Merger Sub will cease, and the Company will become a wholly owned subsidiary of New Parent (the “Merger”). Subject to the terms and conditions of the Merger Agreement, at the date and time when the Merger becomes effective (the “Effective Time”), stockholders of the Company will have the right to receive, in respect to each share of common stock of the Company (“Company Common Stock”) issued and outstanding immediately prior to the Effective Time, a number of American Depositary Shares of New Parent (“New Parent ADSs”) equal to the Exchange Ratio (as defined below). Each New Parent ADS will equal 0.1 shares of ordinary no-par value registered shares of New Parent (“New Parent Ordinary Shares”). Following the Effective Time, each outstanding share of Company Common Stock will cease to be outstanding, will be canceled, and will cease to exist. “Exchange Ratio” means 0.1, unless any of the warrants to purchase Company Common Stock (the “Company Warrants”) issued pursuant to that certain Warrant Agreement, dated as of August 9, 2016, by and between the Company and PEAK6 Investments, L.P., are exercised, in which case “Exchange Ratio” means (i) 0.1 multiplied by (ii) a fraction, the numerator of which is the number of shares of Company Common Stock outstanding as of the Effective Time less the number of shares of Company Common Stock issued pursuant to any Company Warrants, and the denominator of which is the number of shares of Company Common Stock outstanding as of the Effective Time.

The Merger Agreement may be terminated prior to the Effective Time upon certain conditions as set forth in the Merger Agreement.

Consummation of the Merger is subject to customary conditions, including, among others things, approval by the Company's stockholders.

Upon consummation of the Merger, the board of directors of the New Parent (the "New Parent Board") will be composed of (i) three directors to be selected by Affinitas prior to the filing of the preliminary Registration Statement (as defined below), (ii) one director to be selected by the Company prior to the filing of the Registration Statement and (iii) three directors as mutually agreed by the Company and Affinitas prior to the filing of the Registration Statement.

As promptly as practicable after the date of the Registration Statement is declared effective, the Company will take all action necessary in accordance with applicable laws to duly call, set a record date for, give notice of, convene, and hold a meeting of the holders of Company Common Stock (the "Stockholder Meeting"). The Company has agreed to cause the Stockholder Meeting to be held for the purpose of voting upon a proposal to adopt the Merger Agreement and Merger.

Pursuant to the Merger Agreement, New Parent and Affinitas, in cooperation with the Company, have agreed to file with the U.S. Securities and Exchange Commission (the “SEC”) a registration statement on Form F-4 (the “Registration Statement”) pursuant to which the shares of New Parent Ordinary Shares issuable pursuant to the Merger will be registered with the SEC under the Securities Act, and the Company will prepare a proxy statement on Schedule 14A relating to the approval and adoption by the Company’s stockholders at the Stockholder Meeting of the Merger Agreement, the Merger, and the other transactions contemplated by the Merger Agreement (the “Proxy Statement/Prospectus”) for inclusion in the Registration Statement as a prospectus, and to be filed with the SEC as part of the Registration Statement. The Company has agreed to use reasonable best efforts to cause the Registration Statement to become effective under the Securities Act as soon after filing as practicable, and to keep the Registration Statement effective as long as is necessary to consummate the Merger and the transactions contemplated thereby. Further, the Company agrees to use its reasonable best efforts to cause the Proxy Statement/Prospectus to be mailed to its shareholders as promptly as practicable after the Registration Statement becomes effective.

Upon certain events, if the Merger Agreement is terminated by the Company, then the Company is obligated to pay Affinitas a one-time fee equal to the greater of (i) \$1,500,000 or (ii) the fees and expenses of Affinitas related to the Merger.

In connection with the execution of the Merger Agreement, (i) certain stockholders of the Company entered into voting agreements with the Company pursuant to which such stockholders have agreed, among other things, to vote their shares of Company Common Stock in favor of the Merger Agreement and the transactions contemplated thereby and (ii) all stockholders of Affinitas entered into a support agreement pursuant to which such stockholders have agreed, among other things, to vote their shares of Affinitas stock in favor of the transactions contemplated by the Merger Agreement.

Principles of Consolidation

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

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

The consolidated financial statements in this Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Annual Report”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (“US GAAP”) have been condensed or omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2016 was derived from the Company’s audited consolidated financial statements for the year ended December 31, 2016. There have been no material changes in the Company’s significant accounting policies as compared to the significant accounting policies described in the 2016 Annual Report.

Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates,

including those related to revenue recognition, cost of revenue, prepaid advertising, website and software development costs, goodwill, intangible and other long-lived assets, legal contingencies, income taxes and stock-based compensation. In addition, management uses assumptions when employing the Black-Scholes option valuation model to calculate the fair value of granted stock-based awards. Management bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results may differ from these estimates.

2. Adoption of New Accounting Principles

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 provides for a single, principles-based model for revenue recognition that replaces the existing revenue recognition guidance. Subsequently, the FASB has issued the following standards related to ASU 2014-09: ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (“ASU 2016-08”); ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (“ASU 2016-10”); ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”); and ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers (“ASU 2016-20”). The Company must adopt ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20 with ASU 2014-09 (collectively, the “new revenue standard”). In July 2015, the FASB deferred the effective date by one year for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). Early adoption as of the original effective date of December 15, 2016 (including interim reporting periods within those periods) is permitted. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years, and one requiring prospective application of the new standard with disclosure of results under old standards. Management currently expects to adopt ASU No. 2014-09 in the first quarter of 2018, utilizing the full retrospective application. As predominantly all of the performance obligations in the Company’s revenue arrangements include access to services provided over a contractual period consistent with current guidance, management does not expect the adoption of the new revenue standard to have a material impact on the amount and timing of revenue recognized in its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which is intended to improve financial reporting for lease transactions by increasing transparency and comparability among organizations. The guidance in ASU No. 2016-02 requires a lessee to recognize the following at the commencement date for all leases with lease terms of more than 12 months: (i) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis, and (ii) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. The guidance in ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. Management is currently assessing the impact the guidance will have upon adoption.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends the existing guidance in Topic 718, Compensation – Stock Compensation. The guidance in ASU No. 2016-09 simplifies various aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liability, and classification on the statement of cash flows. Under ASU No. 2016-09, all excess tax benefits and tax deficiencies are recorded as a component of the income tax provision in the reporting period in which they occur. The guidance in ASU No. 2016-09 is effective for fiscal periods beginning after December 15, 2016, and interim periods within those fiscal periods, with early adoption permitted. Management has adopted ASU No. 2016-09 prospectively effective January 1, 2017. As of December 31, 2016, the Company’s deferred tax assets included a reduction of federal and state net operating losses attributed to excess tax benefits from stock-based compensation which had not been previously recognized of \$5.3 million. As the Company maintains a full valuation allowance on deferred tax assets, the adoption of ASU 2016-09 on January 1, 2017 resulted in no impact to the consolidated financial statements.