FriendFinder Networks Inc.
Form 10-Q
November 14, 2012

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

xQuarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 2012.

oTransition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from .

Commission File Number
1-34622

FRIENDFINDER NETWORKS INC.
(Exact name of registrant as specified in its charter)

Nevada	13-3750988
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6800 Broken Sound Parkway, Suite 200
Boca Raton, Florida 33487
(Address of registrant's principal executive offices)

(561) 912-7000
(Registrants telephone number, including area code)

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

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 the definitions of “large accelerated filer;” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (check one)

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of November 13, 2012, there were 32,572,761 shares of Common Stock, $0.001 par value, issued and outstanding.

FRIENDFINDER NETWORKS INC.

FORM 10-Q REPORT

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PART I - FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

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

	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash	$ 14,647	$ 23,364
Restricted cash	9,992	11,177
Accounts receivable, less allowance for doubtful accounts of $1,063 and $1,155, respectively	13,303	8,939
Inventories	624	822
Prepaid expenses	3,969	5,645
Deferred tax asset	4,405	4,405
Total current assets	46,940	54,352
Film costs, net	3,928	4,105
Property and equipment, net	7,046	7,830
Goodwill	328,061	332,292
Domain names	56,360	56,093
Trademarks	6,613	6,613
Other intangible assets, net	3,064	16,920
Unamortized debt costs	8,152	11,754
Other assets	2,017	3,405
	$ 462,181	$ 493,364
LIABILITIES		
Current liabilities:		
Long-term debt which matures on September 30, 2013 and current installment of long term debt in 2011, net of unamortized discount of $3,273 and $260, respectively	$ 220,587	$ 8,270
Accounts payable	8,313	11,324
Accrued expenses and other liabilities	75,317	68,930
Deferred revenue	37,511	42,299
Total current liabilities	341,728	130,823
Deferred tax liability	28,310	28,310
Long-term debt, net of unamortized discount of $21,318 and $34,170, respectively	259,208	462,515
Total liabilities	629,246	621,648
Contingencies (Note 15)		
STOCKHOLDERS' DEFICIENCY		
Preferred stock, $0.001 par value — authorized 22,500,000 shares, none issued and outstanding		
	32	31

Common stock, $0.001 par value — authorized 125,000,000 shares issued and outstanding, 32,572,761 shares at September 30, 2012 and 31,219,644 shares at December 31, 2011				
Capital in excess of par value		134,470		133,734
Accumulated deficit		(301,567)		(261,764)
Accumulated other comprehensive loss		–		(285)
Total stockholders' deficiency		(167,065)		(128,284)
	$	462,181	$	493,364

See notes to condensed consolidated financial statements

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FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net revenue				
Service	$ 73,224	$ 77,710	$ 225,245	$ 234,918
Product	4,500	5,026	14,568	14,709
Total	77,724	82,736	239,813	249,627
Cost of revenue				
Service	22,141	24,267	74,904	68,547
Product	3,519	3,646	11,469	11,259
Total	25,660	27,913	86,373	79,806
Gross profit	52,064	54,823	153,440	169,821
Operating expenses:				
Product development	2,420	4,024	10,721	12,080
Selling and marketing	6,404	8,279	25,060	22,679
General and administrative	21,748	22,836	66,062	67,507
Amortization of acquired intangibles and software	3,707	4,060	11,120	11,906
Depreciation and other amortization	800	913	2,361	3,268
Total operating expenses	35,079	40,112	115,324	117,440
Income from operations	16,985	14,711	38,116	52,381
Interest expense	(22,055)	(21,146)	(64,203)	(65,097)
Other finance expenses	–	–	(500)	–
Interest related to VAT liability not charged to customers	(262)	(476)	(1,004)	(1,410)
Foreign exchange (loss) gain, principally related to VAT liability not charged to customers	(463)	1,432	538	(1,521)
Gain on liability related to warrants	–	–	–	391
Loss on extinguishment of debt	–	–	–	(7,312)
Change in fair value of acquisition contingent consideration	–	–	1,400	–
Other non-operating expense net	127	1	(527)	(3,912)
Loss from continuing operations before income tax (benefit)	(5,668)	(5,478)	(26,180)	(26,480)
Income tax (benefit)	–	(82)	–	(5,542)
Loss from continuing operations	$ (5,668)	$ (5,396)	$ (26,180)	$ (20,938)
Loss from discontinued operations	(2,078)	–	(13,623)	–
Net loss	$ (7,746)	$ (5,396)	$ (39,803)	$ (20,938)
Net loss per common share — basic and diluted:				
Continuing operations	$ (0.18)	$ (0.18)	$ (0.83)	$ (1.02)
Discontinued operations	(0.07)	–	(0.43)	–
Net loss	$ (0.25)	$ (0.18)	$ (1.26)	$ (1.02)

Weighted average shares outstanding — basic and diluted	31,537	30,330	31,516	20,505

See notes to condensed consolidated financial statements

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FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(IN THOUSANDS) (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net Loss	$ (7,746)	$ (5,396)	$ (39,803)	$ (20,938)
Other comprehensive loss:				
Foreign currency translation adjustment	–	–	(51)	–
Reclassification of foreign currency translation adjustment related to sale of JigoCity operations	(336)	–	(336)	–
Comprehensive loss	$ (8,082)	$ (5,396)	$ (40,190)	$ (20,938)

See notes to condensed consolidated financial statements

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIENCY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012
(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE DATA)

	Common Stock		Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance at January 1, 2012	31,219,644	$ 31	$ 133,734	$ (261,764)	$ (285)	$ (128,284)
Exercise of warrants	285,617					
Issuance of restricted and non-restricted common shares pursuant to restricted stock compensation plans	1,067,500	1	(1)			
Stock based compensation			754			754
Net Loss				(39,803)		(39,803)
Foreign currency translation adjustment					(51)	(51)
Reclassification to discontinued operations in connection with sale of JigoCity					336	336
Cancellation of warrants in connection with the sale of JigoCity			(17)			(17)
Balance at September 30, 2012	32,572,761	$ 32	$ 134,470	$ (301,567)	$ -	$ (167,065)

See notes to condensed consolidated financial statements

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FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Cash flows from operating activities		
Net loss	$ (39,803)	$ (20,938)
Adjustment to reconcile net loss to net cash provided by operating activities-continuing operations:		
Loss from discontinued operations	13,640	
Amortization of acquired intangibles and software	11,120	11,906
Depreciation and other amortization	2,361	3,268
Amortization of film costs	2,213	2,141
Deferred income tax benefit	–	(5,542)
Non-cash interest, including amortization of discount and debt costs	38,508	35,452
Provision for doubtful accounts	368	105
Change in value of acquisition related contingent consideration	(1,400)	
Gain on warrant liability		(391)
Loss on extinguishment of debt		7,312
Stock based compensation expense	754	2,554
Debt costs	(2,312)	
Other	865	590
Changes in operating assets and liabilities:		
Restricted cash	1,055	(4,218)
Accounts receivable	(4,732)	(112)
Inventories	198	235
Prepaid expenses	(422)	(310)
Film costs	(2,037)	(1,991)
Other assets	96	
Accounts payable	(667)	(1,465)
Accrued expenses and other liabilities	2,407	(2,972)
Deferred revenue	(4,788)	(4,017)
Net cash provided by continuing operations	17,424	21,607
Net cash used in discontinued operations	(6,979)	
Net cash provided by operating activities	10,445	21,607
Cash flows from investing activities:		
Purchases of property and equipment	(2,813)	(4,472)
Cash paid for acquisition		(2,003)
Other	(267)	(49)
Net cash used in investing activities	(3,080)	(6,524)
Cash flows from financing activities:		
Gross proceeds from sale of common stock from initial public offering		50,000
Payment of underwriter discount and other offering costs in connection with initial public offering		(6,724)
Recovery of debt issuance costs		296

Repayment of long-term debt		(16,082)		(76,770)
Net cash used in financing activities		(16,082)		(33,198)
Effect of exchange rate changes on cash				
Net decrease in cash		(8,717)		(18,115)
Cash at beginning of period		23,364		34,585
Cash at end of period	$	14,647	$	16,470
Supplemental disclosures of cash flow information:				
Cash Paid for:				
Interest	$	24,673	$	29,030
Income taxes				30
Non-Cash Investing and Financing Activities:				
Recording of beneficial conversion feature on Non-Cash Pay Second Lien Notes in connection with initial public offering, net of $5,660 of related deferred taxes				8,490
Deferred offering costs written off to capital in excess of par value				13,267
Conversion of Series A and B convertible preferred stock and series B common stock to common stock				12
Common Stock and warrants issued and contingent consideration liability in connection with acquisitions				8,000

See notes to condensed consolidated financial statements

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Description of Business

FriendFinder Networks Inc. (“FriendFinder”), together with Various, Inc. and its other wholly-owned subsidiaries (hereinafter referred to as the “Company”), is an internet and technology company providing services in the social networking and web-based video sharing markets. The business consists of creating and operating technology platforms which run several websites throughout the world appealing to users of diverse cultures and interest groups. The Company is also engaged in entertainment activities consisting of publishing, licensing and studio production and distribution. The Company publishes PENTHOUSE and other adult-oriented magazines and digests. Additionally, the Company licenses the PENTHOUSE name for international publication of adult magazines and for use on various products and provides various adult-oriented multimedia entertainment products and services, including content for pay-per-view programming.

2. Interim Financial Statements

The consolidated interim financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) for reporting on the Quarterly Report on Form 10-Q. The information and note disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. The interim financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2011, which are included in the Company’s Annual Report on Form 10-K.

The Company’s management is responsible for this interim financial information. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, which are of a normal and recurring nature, necessary to present fairly the Company's financial position as of September 30, 2012 and the results of its operations and cash flows for the three months and nine months ended September 30, 2012 and 2011. Interim results may not be indicative of the results that may be expected for the year.

3. Liquidity

On October 27, 2010, the Company completed a debt restructuring which consolidated substantially all of its debt into three tranches with maturities on September 30, 2013 and on April 30, 2014. On May 16, 2011, the Company completed its initial public offering ("IPO") and issued 5,000,000 shares of common stock resulting in $43.5 million of net proceeds. On May 19, 2011, the Company redeemed $39.5 million principal amount of long-term notes from the net proceeds of the IPO at 110% of principal.

As described in Note 9(d), in March 2012, the indentures governing the New First Lien Notes and Cash-Pay Second Lien Notes were modified to, among other changes, provide for a reset of the Company’s Consolidated EBITDA minimum requirement (as defined) to be achieved over a period of four consecutive fiscal quarters, require the Company to maintain a certain level of Qualified Cash (as defined) over certain calendar periods, amend the Excess Cash Flow calculation to provide for 85% of Excess Cash Flow (as defined) be applied quarterly as a prepayment against the notes at 110% of principal and state that certain covenant violations under the Non-Cash Pay Second Lien Notes would not cause a default under the New First Lien Notes or the Cash Pay Second Lien Notes. The Company did not make an Excess Cash Flow payment due on November 5, 2012 and therefore, the New First Lien Notes and

Cash Pay Second Lien Notes are in default as of November 5, 2012, and the grace period with respect thereto lapsed on November 14, 2012. As such, post-default interest of 17.5% accrues commencing as of the default date. The Company has received forbearance agreements from over 80% of its senior lenders and all of its Cash Pay Second Lien lenders with respect to such defaults in exchange for a forbearance fee equal to one-half of a percent (0.5%) of the outstanding principal amount of the notes held by such lender. The forbearance agreement remains in place until the earlier of February 4, 2013, a default other than for not making the Excess Cash Flow payment, acceleration by the Trustee, or certain other circumstances. The New First Lien Notes and Cash Pay Second Lien Notes which mature on September 30, 2013, are classified as current liabilities in the accompanying balance sheet at September 30, 2012.

As of March 31, 2012, June 30, 2012 and September 30, 2012, the Company was not in compliance with certain covenants contained in the indenture governing the Non-Cash Pay Second Lien Notes. The Trustee of the Non-Cash Pay Second Lien Notes and the Required Holders thereof waived compliance with these covenants for the periods ended March 31 and June 30, 2012 but did not waive compliance as of September 30, 2012. However, neither the Trustee of the Non-Cash Pay Second Lien indenture nor the holders of the Non-Cash Pay Second Lien Notes may accelerate such Notes or take any other enforcement action until the New First Lien Notes are paid in full. As a result of the inability to accelerate as well as that the default on the First Lien Notes occurred subsequent to September 30, 2012, the Company's Non-Cash Pay Second Lien Notes which mature on April 30, 2014, are classified as non-current liabilities in the accompanying consolidated balance sheet at September 30, 2012.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

3. Liquidity (continued)

The New First Lien Notes and Cash Pay Second Lien Notes are subject to a maturity date acceleration by the lenders; however, over 80% of the New First Lien lenders and all of the Cash Pay Second Lien lenders have entered into forbearance agreements with the Company. The First Lien Notes and Cash Pay Second Lien Notes mature on September 30, 2013 and the Non-Cash Pay Second Lien Notes mature on April 30, 2014. The Company will be required to either restructure or refinance these notes prior to their maturity dates. The Company's inability to accomplish a successful restructuring or refinancing of the notes will have a material adverse effect on the Company's financial condition and may affect its ability to continue operations. Based on cash provided from operating activities (after interest payments on debt) during the past several years and the current nine-month period, a substantial percentage of which has been used to make principal payments on debt and its forecasts of future operating cash flow, the Company anticipates that it will be able to either restructure or refinance the notes; however there is no assurance that the Company will be able to accomplish such transactions on acceptable terms, or at all.

4. new accounting pronouncements

In September 2011, the Financial Accounting Standards Board (the "FASB") issued new authoritative accounting guidance which will allow entities to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company adopted this guidance effective January 1, 2012 without impact to its financial statements.

In June 2011, the FASB issued authoritative guidance that amends the presentation of comprehensive income in the financial statements by requiring an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The update also eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance is effective for interim and annual reporting periods beginning on or after December 15, 2011, with early adoption permitted. The Company adopted this guidance effective January 1, 2012.

In July 2012, the FASB issued authoritative guidance to simplify the assessment of testing the impairment of indefinite-lived intangible assets other than goodwill. The guidance allows the Company to do an initial qualitative assessment to determine whether it is more likely than not that the fair value of its indefinite-lived intangible assets are less than their carrying amounts prior to performing the quantitative indefinite-lived intangible asset impairment test. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 with early adoption permitted. The Company does not believe the adoption of this guidance will have a material effect on its financial statements.

5. Fair Value of Financial Instruments

The fair value hierarchy, established under authoritative accounting guidance, ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Inputs other than quoted prices in active markets, which are directly or indirectly observable for the asset or liability.
- Level 3 – Unobservable inputs for the asset or liability where there is little or no market data, which requires the reporting entity to develop its own assumptions.

The carrying amounts of receivables and payables approximate their fair values due to the short-term nature of these financial instruments. As of September 30, 2012, the carrying value of long-term debt was $479.8 million compared to its estimated fair value of $231.0 million. As of December 31, 2011, the carrying value of long-term debt was $470.9 million compared to its estimated fair value of $380.8 million. The fair value of First Lien Notes of $175.4 million (2012) and $209 million (2011) is based on quoted market prices (level 1), the fair value of the Cash-Pay Second Lien Notes of $5.6 million (2012) and $7.3 million (2011) for which no market activity exists is based on a discount to the quoted price of the New First Lien Notes (level 3) and the fair value of Non-Cash Pay Second Lien Notes of $53.9 million (2012) and $164.5 million (2011) for which trading is inactive is based on third party pricing information (level 2).

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

6. Per Share Data

Basic and diluted net loss per common share is based on the weighted average number of shares of outstanding common stock (excluding nonvested shares) and Series B common stock including shares underlying common stock purchase warrants which are exercisable at the nominal price of $0.0002 per share. Inasmuch as the Series B common stock, all the outstanding shares of which were exchanged for common stock in 2011, participated in any dividends and shared in the net loss on a pro rata basis with the common stock based on the total number of common shares outstanding, the net loss per common share, basic and diluted, as presented in the Company's statements of operations is consistent with the two-class method.

Weighted average shares outstanding — basic and diluted is comprised of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Common Stock	31,537	30,012	31,477	16,726
Series B common stock		33		942
Common stock purchase warrants		285	39	2,837
	31,537	30,330	31,516	20,505

In computing diluted loss per share for the three and six month periods, no effect has been given to the common shares issuable at the end of the period upon conversion or exercise or vesting of the following anti-dilutive securities that could potentially dilute basic earnings per share in future periods (in thousands):

	September 30,	
	2012	2011
Warrants	2,325	6,437
Convertible Non-Cash Pay Second Lien Notes	8,311	8,311
Non-vested shares	936	
Employee stock options	1,138	608
Total common shares issuable	12,710	15,356

7. Acquisition Of JigoCity And Related Contingent Consideration

On September 7, 2011, pursuant to a merger agreement, a newly-formed wholly-owned subsidiary of FriendFinder acquired the assets and assumed the liabilities of BDM Global Ventures Limited ("BDM"), a British Virgin Islands ("BVI") limited company formed in July 2010, which, through wholly-owned BVI limited companies and their foreign subsidiaries, owns and operates JigoCity, a global social commerce organization committed to providing members, through a suite of websites, with high quality daily deals that are relevant to their individual lifestyles. BDM and its subsidiaries are hereafter referred to as JigoCity. Concurrently with entering into the merger agreement, FriendFinder entered into an equity put agreement with the former shareholders of JigoCity pursuant to which such shareholders have the option to sell all of their shares of common stock and warrants received as consideration in the merger back to FriendFinder in exchange for the return of 70% of the equity in JigoCity if the volume-weighted average price of FriendFinder's common stock fails to equal or exceed $12.00 per share during any

10 trading day period between the closing date of the merger and the later of June 30, 2014 and the date upon which FriendFinder current indentures are fully discharged, or if an "indenture modification" is made, as defined under the equity put agreement, the later of June 30, 2014 and the date that the indenture modification takes place. Additionally, pursuant to the equity put agreement, if the shareholders exercise the put right, FriendFinder has a right to pay them in common stock and/or cash, having a combined value as of the later of the above dates equal to the product of (i) 2,209,414 shares of common stock (subject to dilutive adjustment) and (ii) the difference between the highest 10 day volume-weighted average price attained by FriendFinder common stock during such period and $12.00, in which case the put right terminates.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

7. Acquisition of JigoCity and Related Contingent Consideration (Continued)

A liability was recognized for an estimate of the acquisition date fair value of the acquisition-related contingent consideration which may be paid. The liability was initially measured as the present value of the put option determined based on estimated future trading prices of FriendFinder's common stock between September 7, 2011 and June 30, 2014 and on the estimated future equity value of JigoCity during such period calculated on multiple scenarios using a Monte Carlo simulation methodology. The fair value measurement of the acquisition-related contingent consideration is based on unobservable inputs that are supported by little or no market activity and reflect FriendFinder's own assumptions. Key assumptions include expected volatility in both the value of JigoCity and in FriendFinder's common stock during the above period. Changes in the fair value of the contingent consideration subsequent to the acquisition date, as re-measured on each balance sheet, will be recognized in earnings until the liability is eliminated or settled. In the second quarter of 2012, the Company decided to either sell or discontinue all operations of JigoCity thereby resulting in the elimination of the liability. Changes in the carrying value of the liability (included in accrued expenses and other liabilities) during the nine months ended September 30, 2012 follows (in thousands):

Balance at beginning of period		1,400
Reduction in fair value (a)		(1,400)
Balance at close of period	$	–

(a)Caused by the closing and disposition of JigoCity operations in all countries

On August 1, 2012, in connection with the sale of the JigoCity operations, the equity put agreement was terminated.

The Company has not presented pro-forma results of operations for the 2011 periods as if JigoCity had been acquired as of January 1, 2011 as the operations have been discontinued and sold (see Note 12).

8. VAT Liabilities

Effective July 1, 2003, as a result of a change in the law in the European Union, Various, Inc., was required to collect VAT from customers in connection with their use of internet services in the European Union provided by Various and remit the VAT to the taxing authorities in the various European Union countries. As Various did not separately charge its customers for, or remit, the VAT, a liability has been recorded at the date of acquisition in October 2004 to reflect the estimated VAT which should have been collected and remitted on Various' revenue derived from the various European Union countries since July 1, 2003 or other local implementation date. In addition, a liability has been recorded at the date of acquisition for interest and penalties related to the unremitted VAT and failure to file tax returns. Effective July 2008, the Company registered with the European Union and on July 29, 2008 began separately charging VAT to its customers. The aggregate liability included in accrued expenses and other liabilities, which is denominated in Euros, amounted to $40,064,000 and $41,011,000 at September 30, 2012 and December 31, 2011, respectively, and includes VAT ($18,803,000 and $20,294,000), interest ($13,147,000 and $12,696,000) and penalties ($8,114,000 and $8,020,000). The consolidated statements of operations for the three and nine months ended September 30, 2012 and 2011 respectively, include foreign currency transaction (loss) gain of ($463,000) and $538,000 and $1,432,000 and ($1,521,000) related to the liability, and interest related to VAT of $262,000, $1,004,000 and $476,000 and $1,410,000, respectively. As of September 30, 2012 the Company has reached settlement with the taxing authority of certain European Union countries related to VAT for periods prior to July 1, 2008 and has not yet reached settlement or has reached partial settlement, with the taxing authority in the following European Union countries: Cyprus, Germany, Italy, Luxembourg, Netherlands, Portugal and Sweden. The liability as of September 30, 2012 includes $17,035,000 of VAT liability for countries that we have reached settlements with, including a gain of $13,237,000 which we are deferring until we have completed all the terms and conditions of each country's settlements. Settlements have not been reached for the $20,458,000 balance of the VAT liability. In addition, the Company has $2,571,000 in VAT liability related to current VAT charged to customers. On October 8, 2009, the Company agreed that if the costs of eliminating the pre-acquisition VAT liabilities are less than $29 million, then the principal of the Subordinated Convertible Notes issued to the former owners of Various would be increased for the unused portion of the $29 million plus interest on such difference.

Gain on settlement of VAT liabilities will be recognized upon the Company satisfying the conditions of the settlement and to the extent the aggregate carrying amount of settled VAT liabilities exceeds the agreed settlement amounts and the then potential maximum increase in the principal of the Subordinated Convertible Notes. In October 2010, the Subordinated Convertible Notes were exchanged for Non-Cash Pay Second Lien Notes and in connection therewith, the Company agreed that the principal increase would apply to the Non-Cash Pay Second Lien Notes. Various has been notified that the German tax authorities and the Office of the District Attorney in Bonn have been investigating Various' former Chief Executive Officer for alleged intentional evasion of VAT on revenue collected from customers located in Germany commencing in 2003. The German tax authority has attempted unsuccessfully to freeze assets in bank accounts maintained by subsidiaries of Various in Germany, but did freeze assets in the amount of €610,343 held by Various' credit card processor located in the Netherlands to secure the VAT estimated by the revenue tax authorities to be due from Various from revenue from internet websites in Germany. At September 30, 2012 and December 31, 2011, the frozen Euros included in restricted cash approximated $785,000 and $790,000, respectively.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

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9. Long-Term Debt

Long-term debt consists of the following (in thousands):

	September 30, 2012		December 31, 2011	
	Principal	Unamortized Discount	Principal	Unamortized Discount
Debt issued by FriendFinder and INI on October 27, 2010				
14% New First Lien Notes due 2011-2013 (a)(d)	$ 212,988	$ 3,147	$ 228,375	$ 5,602
14% Cash Pay Second Lien Notes due 2013 (b)(d)	9,622	77	10,317	138
11.5% Non-Cash Pay Second Lien Notes, due 2014 (c)(d)	280,526	21,318	265,273	28,519
Other (e)	1,250	49	1,250	171
	$ 504,386	$ 24,591	$ 505,215	$ 34,430
Less: unamortized discount	(24,591)		(34,430)	
Less: long-term debt maturing in the following twelve months, net of unamortized discount of $3,273 and $260, respectively	(220,587)		(8,270)	
	$ 259,208		$ 462,515	

(a) The New First Lien Notes, approximately $71.8 million principal amount of which are held by a more than 10% stockholder at September 30, 2012, were issued with an original issue discount of $6.1 million, or 2.0%. The notes mature on September 30, 2013 and accrue interest at a rate per annum equal to 14.0%. Interest on the notes is payable quarterly on March 31, June 30, September 30 and December 31 of each year. Principal on the New First Lien Notes was payable quarterly to the extent of 75% of Excess Cash Flow, as defined, at 102% of principal, subject to the pro-rata sharing with the Cash Pay Second Lien Notes. In March 2012, the Excess Cash Flow percentage and the percentage of principal repaid was increased to 85% and 110%, respectively. The New First Lien Notes are guaranteed by domestic subsidiaries of FriendFinder and Interactive Network, Inc. ("INI") a domestic subsidiary of FriendFinder and co-issuer of the notes and are collateralized by a first-priority lien on all of the Company's assets as well as a pledge of stock of subsidiaries. The New First Lien Notes are redeemable prior to maturity at the option of the Company, in whole but not in part, at 110% of principal, plus accrued and unpaid interest. Noteholders have the option of requiring the Company to repay the New First Lien Notes and Cash Pay Second Lien Notes in full upon a Change of Control, as defined, at 110% of principal. The Company shall also repay the New First Lien Notes and, in certain circumstances, the Cash Pay Second Lien Notes, with proceeds received from any debt or equity financing (including a secondary offering) and asset sales of more than $25 million at 110% of principal, and with proceeds from other asset sales, insurance claims, condemnation and other extraordinary cash receipts at principal, subject to certain exceptions. On May 19, 2011, the Company redeemed $37,832,000 principal amount of New First Lien notes and $1,709,000 principal amount of

Cash Pay Second Lien notes from the net proceeds of the IPO and incurred a loss on extinguishment of debt of approximately $7.3 million consisting of a redemption premium of $3.9 million and write-off of discount and deferred offering costs of $3.4 million.

(b) The Cash Pay Second Lien Notes, all of which were issued to entities controlled by stockholders who are also officers and directors, were issued with an original issue discount of $276,000, or 2%, mature on September 30, 2013 and have identical terms to those of the New First Lien Notes, except as to matters regarding collateral, subordination, enforcement and voting. The Cash Pay Second Lien Notes are collateralized by a fully subordinated second lien on substantially all of the assets of the Company, pari passu with the Non-Cash Pay Second Lien Notes, and will vote with the New First Lien Notes on a dollar for dollar basis on all matters except for matters relating to collateral, liens and enforcement of rights and remedies. As to such matters, the Cash Pay Second Lien Notes will vote with the Non-Cash Pay Second Lien Notes.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

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9. Long-Term Debt (Continued)

(c) The Non-Cash Pay Second Lien Notes, approximately $185.0 million principal amount of which are held by more than 10% stockholders and affiliates, mature on April 30, 2014 and bear interest at 11.5%, payable semi-annually on June 30 and December 31, which may be paid in additional notes at the Company's option. While the New First Lien Notes are outstanding, interest must be paid with additional notes. On June 30, 2012 and 2011, interest amounting to $15.3 million and $28.1 million respectively, was paid through issuance of additional Non-Cash Pay Second Lien Notes. The Non-Cash Pay Second Lien Notes are guaranteed by the domestic subsidiaries of FriendFinder and INI, co-issuers of the notes, and collateralized by a second priority lien on all of the Company's assets and a pledge of the stock of subsidiaries; however, such security interest is subordinate to the prior payment of the New First Lien Notes. The Non-Cash Pay Second Lien Notes are redeemable, at the option of the Company, in whole but not in part, at 100% of principal plus accrued and unpaid interest. Upon the payment in full of the New First Lien Notes, principal on the Non-Cash Pay Second Lien Notes is payable quarterly to the extent of 75% of Excess Cash Flow, as defined, at 102% of principal subject to pro-rata sharing with the Cash Pay Second Lien Notes. Noteholders have the option of requiring the Company to repay the Non-Cash Pay Second Lien Notes in full upon a Change of Control, as defined, at 110% of principal plus accrued and unpaid interest. If the New First Lien Notes are paid in full, the Company shall repay the Non-Cash Pay Second Lien Notes and Cash Pay Second Lien Notes on a pro-rata basis with proceeds received from any debt or equity financing (including a secondary offering), and asset sales of more than $25 million at 110% of principal plus accrued and unpaid interest and with proceeds of other asset sales, insurance claims, condemnation and other extraordinary cash receipts at principal, subject to certain exceptions.

As a result of the consummation of the IPO in May 2011, the Non-Cash Pay Second Lien Notes became convertible into 8,310,763 shares of common stock at an IPO price of $10.00 per share. As a result thereof, a beneficial conversion feature of $14,150,000 related to the Non-Cash Pay Second Lien Notes was recognized and recorded as a discount on the notes with a corresponding increase to additional paid-in capital. In addition, a related deferred tax liability of approximately $5.7 million resulting from the difference between the carrying value of the notes and their tax basis attributable to recording the note discount was recognized with a corresponding reduction to additional paid-in capital. The beneficial conversion feature was measured based on the difference, on the deemed issuance date of the notes, between (a) the adjusted conversion price of the notes, calculated based on the fair value of the notes (which was less than stated principal) and (b) the estimated fair value of the Company's common stock, multiplied by the 8,310,763 shares obtainable on conversion.

As described in Note 8, if the costs of eliminating the pre-acquisition VAT liabilities is less than $29 million, exclusive of costs paid from an escrow fund which was set up in connection with the acquisition, then the principal amount of the Non-Cash Pay Second Lien Notes will be increased by the issuance of additional such notes for the unused portion of the $29 million, plus interest at 6% on the increased principal from the date of acquisition.

As described in (d) below, as of March 31, 2012, June 30, 2012 and September 30, 2012, the Company was not in compliance with certain covenants contained in the indenture governing the Non-Cash Pay

Second Lien Notes.

(d) The New First Lien Notes, the Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes (1) require the Company to maintain minimum specified levels of EBITDA and liquidity and financial ratios, including debt and coverage ratios, all as defined; (2) provides for certain limitations including limits on indebtedness, lease obligations, VAT payments and investments; and (3) prohibits dividends and other payments with respect to the Company's equity securities.

As described above, the New First Lien Notes, the Cash Pay Second Lien Notes and the Non-Cash Pay Second Lien Notes were co-issued by FriendFinder and its wholly-owned subsidiary INI and guaranteed by their domestic subsidiaries, which are 100% owned directly or indirectly by FriendFinder. FriendFinder and INI are holding companies and have no independent assets or operations. The subsidiary guarantees are full and unconditional and joint and several. Non-guarantor subsidiaries consisted of wholly-owned foreign subsidiaries of JigoCity which were acquired in September 2011 and sold in August 2012 (see Note 12).

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

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9. Long-Term Debt (Continued)

The Company had agreed to consummate an exchange offer pursuant to an effective registration statement to be filed with the SEC to allow the holders of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes to exchange their notes for a new issue of substantially identical notes. In addition, the Company has agreed to file, under certain circumstances, a shelf registration statement to cover resales of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes. On August 1, 2011, the Company filed a registration statement on Form S-4 with the SEC relating to the exchange offer. In October, 2011, due to interpretations of applicable laws and regulations from the staff of the SEC which did not allow an exchange offer for the above referenced notes, the Company withdrew its exchange offer. On October 17, 2011, the Company filed a registration statement on Form S-1 to cover re-sales of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes. The registration statement was declared effective by the SEC on December 19, 2011. The Company has agreed under the indentures governing the above referenced notes to use its reasonable best efforts, subject to applicable law, to keep the registration statement continuously effective until the earlier to occur of (A) the third anniversary of the issue date of the respective notes and (B) such time as there are no notes outstanding. In the event that the Company fails to satisfy such requirement, the interest rate on the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes will be increased by 3.5 percentage points.

On March 27, 2012, the Company entered into Supplemental Indentures with the Trustee under the Company’s 14% First Lien Notes due 2013 and 14% Cash Pay Second Lien Notes due 2013. The Supplemental Indentures were approved by the Required Holders and provided for modifications which were substantially the same under each such indenture. Each Supplemental Indenture provides that the Consolidated EBITDA minimum requirement (as defined) be reset to provide that for the period of any four consecutive fiscal quarters, Consolidated EBITDA shall not be less than $65 million through December 31, 2012, not less than $75 million through March 31, 2013, and not less than $80 million through June 30, 2013. Consolidated EBITDA for the fiscal quarter ending September 30, 2012 shall not be less than $16 million and the combined Consolidated EBITDA for the third and fourth fiscal quarters of 2012 (ending September 30, 2012 and December 31, 2012, respectively) shall not be less than $36 million. In addition, starting with the fiscal quarter ending March 31, 2013, the average of any two consecutive quarters going forward shall not be less than $20 million. A consent fee of 1% of the current outstanding amount of notes under each indenture, or $2.3 million, was paid on April 2, 2012. The Supplemental Indentures also provide that the minimum amount of Qualified Cash (as defined) of the Issuers and their respective Subsidiaries shall not be less than (i) $10 million over a 15 calendar day rolling average period and (ii) $5 million at any time; provided, however, that for a six month period commencing on the date the consent fee is paid, such minimum amount of Qualified Cash required under this covenant shall be reduced by an amount equal to the consent fee. The Minimum Consolidated Coverage Ratio, Total Debt Ratio and First Lien Debt Ratio, all as defined, were reset based on the changes to the minimum Consolidated EBITDA requirements set forth above. The Excess Cash Flow definition was amended to increase the Excess Cash Flow prepayment percentage to 85%, except that the Company may, in its sole discretion, forego applying an amount of up to 5% of Excess Cash Flow to the prepayment percentage provided the Issuers purchase an equivalent amount of notes in the open market prior to the due date of such Excess Cash Flow payment. Such principal repayments from Excess Cash Flow shall be paid in cash equal to 110% of the principal amount repaid, an increase from 102%. Cash compensation to each person that is an owner or beneficial holder of 5% of the stock of the Company is limited to $500,000 per year. The requirement that the Company maintain a debt rating was removed and the cross default provision was amended so that a covenant violation under the 11.5% Non-Cash Pay Second Lien Notes due 2014 would not, under certain circumstances, cause a default under the New First Lien Notes or the Cash Pay Second Lien Notes. Finally, certain other provisions in each of the indentures were modified, including restrictions on incurrence of capital leases, open market purchases of the notes by the Company, issuance of stock dividends and asset holdings of foreign subsidiaries.

The Company has determined that the New First Lien Notes and Cash Pay Second Lien Notes, as modified, were not substantially different than such notes prior to the modifications based on the less than 10% difference in present values of revised cash flows, including the consent fee, as compared with the remaining cash flows under the terms of the notes prior to modification and, accordingly, the modifications were accounted for as if the New First Lien Notes and Cash Pay Second Lien Notes were not extinguished. Accordingly, the $2.3 million consent fee has been capitalized as unamortized debt expense and is being amortized as an adjustment to interest expense over the remaining terms of the modified notes using the interest method.

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9. Long-Term Debt (Continued)

The Company did not make an Excess Cash Flow payment of $11.3 million due in November, 2012 and therefore, the New First Lien Notes and Cash Pay Second Lien Notes are in default as of November 5, 2012, and the grace period with respect thereto lapsed on November 14, 2012. As such, post-default interest of 17.5% accrues commencing as of the default date. The Company has received forbearance agreements from over 80% of its senior lenders and all of its Cash Pay Second Lien lenders with respect to such defaults in exchange for a forbearance fee equal to one-half of a percent (0.5%) of the outstanding principal amount of the notes held by such lender. The forbearance agreement remains in place until the earlier of February 4, 2013, a default other than for not making the Excess Cash Flow payment, acceleration by the Trustee, or certain other circumstances. The New First Lien Notes and Cash Pay Second Lien Notes which mature on September 30, 2013 are classified as current liabilities in the accompanying balance sheet at September 30, 2012.

The indenture governing the Non-Cash Second Lien Notes was not modified and as a result, the Company did not comply with the minimum EBITDA requirement (as defined) of $90 million for the four consecutive fiscal quarters ended March 31, 2012, June 30, 2012 and September 30, 2012. The Company's EBITDA was calculated for such periods to be $78.2 million, $69.0 million and $71.2 million, respectively. In addition, the Total Debt Ratio (as defined) for such periods of 6.3:1.0, 7.4:1.0 and 7.1:1.0 was above the required maximum level of 6.1:1.0. Further, during the quarters ended June 30, 2012 and September 30, 2012, the Company violated certain other debt ratios. In addition, from time to time, the Company did not meet the minimum liquidity requirement of $10 million of Qualified Cash and did not meet the reporting requirement with respect thereto. Under the terms of an Intercreditor and Subordination Agreement among the Trustees under the New First Lien Note Indenture, the Cash Pay Second Lien Note Indenture and the Non-Cash Pay Second Lien Indenture, neither the Trustee under the Non-Cash Pay Second Lien Indenture nor the holders of Non-Cash Pay Second Lien Notes may accelerate the Notes or take any other Enforcement Action (as defined) until the New First Lien Notes are paid in full.

On May 11, 2012, the Trustee of the Non-Cash Pay Second Lien Notes and the Required Holders thereof waived the EBITDA covenant violation and the Total Debt Ratio for the quarter ended March 31, 2012 and minimum liquidity requirement covenant violations through August 14, 2012, as well as the failure to timely comply with minimum liquidity requirement and the reporting requirement thereof. On August 10, 2012, the Company received a waiver from the Trustee and Required Holders related to its failure to meet the minimum EBITDA requirement as well as the Total Debt and other ratios for the quarter ended June 30, 2012 and the minimum liquidity requirement waiver was extended through November 14, 2012. As a result of receiving these waivers, the Company was not subject to the post-default interest rate of 15%. The Company did not receive a waiver from the Trustee and Required Holders related to its failure to meet the minimum EBITDA requirement as well as the Total Debt and other ratios for the quarter ended September 30, 2012 and the minimum liquidity requirement waiver was not extended. Accordingly, the Company is subject to the post-default interest rate of 15% as of November 14, 2012. As a result of the inability to accelerate the notes as well as that the default on the New First Lien Notes referred to above occurred subsequent to September 30, 2012, the Company's Non-Cash Pay Second Lien Notes are classified as non-current liabilities in the accompanying balance sheet at September 30, 2012.

(e) In connection with the restructuring of Subordinated Convertible Notes issued in connection with the acquisition of Various, the Company agreed to pay $3.2 million of fees to the former owners of Various of which $1 million is payable in each of 2010 through 2012 and $250,000 is payable in the first quarter of 2013. The obligation was recorded at a present value of $2.3 million using a discount rate of 15%.

10. Warrants

In January and April 2012, warrants to purchase 235,833 and 49,784 shares of common stock at $0.0002 per share were exercised. As of September 30, 2012, there were 2,325,451 outstanding warrants to purchase voting common stock of the Company, issued in connection with the acquisition of JigoCity. These warrants have an expiration date of December 2021 and exercise prices between $5.00 and $18.00.

On August 1, 2012, warrants exercisable into 4,111,400 shares of common stock of the Company with exercise prices ranging from $7.00-$18.00 per share originally issued when the Company acquired the operations of JigoCity were cancelled in connection with the sale of the remaining JigoCity operations (see Note 12).

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FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

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11. Stock Plans

On April 3, 2008, the Company's Board of Directors adopted the 2008 Stock Option Plan (the "Plan"), which was amended and restated and approved by our stockholders on February 1, 2010. The maximum number of shares for which stock options may be granted under the Plan is 1,343,997 shares, subject to adjustment. Stock options may be issued to employees, directors and consultants, selected by the compensation committee of the Board of Directors. Under the terms of the Plan, the options granted will expire no later than 10 years from the date of grant and will vest 20% on the first anniversary of the grant date and 20% on each succeeding four anniversaries of the grant date, provided, however, that an optionee may exercise the vested portion of a stock option only after that date which is 18 months after the date of the Company's IPO on May 16, 2011. The exercise price of an option shall be the closing price of the common stock on a national securities exchange on the date immediately preceding the date of grant. The exercise price per share of any stock option agreement issued prior to May 16, 2011 was set at $10.00 per share, representing the price per share that the Company's common stock was sold to the public pursuant to the IPO on May 16, 2011.

A summary of the changes in outstanding stock options for the nine months ended September 30, 2012 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Terms (Years)
Options outstanding at January 1, 2012	590,250	$ 10.00	$ 8.38	6.58
Granted	620,918	$ 1.39	$ 0.86	9.33
Forfeited	(73,250)	$ 7.19	$ 5.93	-
Options outstanding at September 30, 2012	1,137,918	$ 5.51	$ 4.46	7.65
Options exercisable at September 30, 2012	428,900	10.00	-	5.79
Options exercisable and expected to be exercisable at September 30, 2012	952,848	$ 5.93	-	7.47

Upon the successful completion of the IPO on May 16, 2011, compensation cost was accrued for each vesting tranche over the requisite service period commencing on the date the options were granted and ending on the later of the vesting date or 18 months after the date of the IPO. Accordingly, in the quarter ended June 30, 2011, a cumulative adjustment of approximately $2 million was made to record compensation cost which accrued prior to May 16, 2011, based on the fair value of the options on the IPO date. For the three months and nine months ended September 30, 2012, compensation cost related to options amounted to $99,000 and $539,000, respectively.

Outstanding stock options had no intrinsic value as of September 30, 2012. As of September 30, 2012, there was approximately $565,000 of unrecognized compensation cost related to outstanding stock options which will be recognized over a weighted average period of 3.9 years.

The grant date fair value for options outstanding at January 1, 2012 was estimated on the IPO date using the Black-Scholes option pricing model using the following assumptions: dividend yield of 0%; expected volatility of

106%; a risk-free interest rate of 2.31%, and expected life of 6.5 years. For the options granted in the nine months ended September 30, 2012 the following assumptions were used: dividend yield of 0%; expected volatility of 106.4%; a risk-free interest rate of 2.31%, and expected life of 6.5 years. The expected dividend yield is based on the Company's historical dividend yield. The expected volatility was based on the average of historical and implied volatilities for a period comparable to the expected life of the options of certain entities considered to be similar to the Company. The expected life is based on the simplified expected term calculation permitted by the SEC which defines the expected life as the average of the contractual term of the options and the weighted-average vesting period for all option tranches. The risk-free interest rate is based on the annual yield on the grant date of a zero-coupon U.S. Treasury bond the maturity of which equals the option's expected life.

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11. Stock Plans (Continued)

On March 23, 2009, the Company's board of directors approved a 2009 Restricted Stock Plan (the "Restricted Plan") which became effective upon the consummation of the Company's IPO. The aggregate number of shares of restricted stock that may be granted under the plan is limited to one percent of the fully-diluted equity of the Company on the date the IPO was consummated, or 393,875 shares. The Compensation Committee of the Board of Directors is charged with administering the Restricted Plan and all directors, employees and consultants of FriendFinder or of any subsidiary are eligible to receive restricted stock under the Restricted Plan. Restricted stock granted under the Restricted Plan will generally vest on the third anniversary of the grant date, subject to the recipient's continued service. Restricted shares will also vest prior to the third anniversary of the grant date if the recipient's employment has been terminated under certain conditions. Upon the termination of a recipient's employment, unvested shares of restricted stock will be subject to repurchase by the Company at a price equal to $.10 per share or in certain cases as determined by the Compensation Committee, the fair market value as the date of issuance. Prior to vesting, the restricted shares may not be sold, assigned, transferred or pledged by the recipient. As of December 31, 2011, no restricted shares had been granted under the Restricted Plan. In the nine months ended September 30, 2012, 380,000 restricted shares were granted under the Restricted Plan. As of September 30, 2012 there was $509,000 of total unrecognized compensation cost related to non-vested restricted stock compensation to be recognized over the 3 year vesting period. For the nine months ended September 30, 2012, there was $31,000 of compensation cost related to restricted shares.

On March 29, 2012, the Company's Board of Directors adopted the FriendFinder Networks Inc. 2012 Stock Incentive Plan (the "2012 Stock Incentive Plan"), which was approved by the Stockholders of the Company on May 30, 2012. The 2012 Stock Incentive Plan authorizes the Compensation Committee of the Board to grant stock options, restricted stock and other awards that are valued in whole or in part by reference to, or otherwise based on, the Company's common stock for up to 2,000,000 shares of common stock to our employees, officers, consultants and directors. Stock granted under the 2012 Stock Incentive Plan will generally vest between the third and fifth anniversary of the grant date, subject to the recipient's continued service. In the nine months ended September 30, 2012, 556,000 restricted shares and 125,000 unrestricted shares were granted under the 2012 Stock Incentive Plan. As of September 30, 2012, there was $1,249,000 of total unrecognized compensation cost related to non-vested restricted stock compensation to be recognized over the 3 to 5 year vesting periods. For the nine-months ended September 30, 2012, there was $264,000 of compensation cost related to restricted and unrestricted shares.

12. Discontinued Operations

During the first quarter of 2012, the Company took steps to streamline its operations and, in connection therewith, closed JigoCity operations acquired in September 2011 located in China, Singapore, Hong Kong, Malaysia and Australia. In the second quarter of 2012, the Company decided to either sell or discontinue its one remaining JigoCity operation in Taiwan and on August 1, 2012, FriendFinder sold all of the shares of its wholly owned subsidiary, JGC Holdings Limited ("JGC"), a British Virgin Islands Business Company that owns the operations of JigoCity to JGC Acquisition LLC (the "Purchaser"), an entity controlled by Anthony R. Bobulinski, the former owner of JigoCity. FriendFinder sold the shares for cash consideration in the amount of $1.00 and cancellation of warrants exercisable into 4,111,400 shares of common stock of the Company with exercise prices ranging from $7.00-$18.00 per share originally issued when the Company acquired the operations of JigoCity. Such warrants were valued at approximately $17,000 at date of sale using a Black Scholes option pricing model and the following assumptions: price of the

Company's stock of $0.85; dividend yield of 0%; expected volatility of 30%; a risk-free interest rate of 1.67% and remaining term of 9.5 years. Additionally, FriendFinder agreed to reimburse Purchaser up to an aggregate amount of $2.16 million for legitimate business expenses of the Purchaser or JGC for the time period from July 2012 through June 2013. The Purchaser has agreed to indemnify and hold harmless FriendFinder and its affiliates in certain circumstances. As part of the sale transaction, the equity put agreement entered in connection with FriendFinder's acquisition of JigoCity was terminated (see Note 7) and 500,000 shares of common stock of FriendFinder previously issued in connection with FriendFinder's acquisition of JigoCity will remain in escrow until no later than December 31, 2012 to secure a guaranty by Global Investment Ventures, LLC, an entity wholly-owned by Mr. Bobulinski, of Purchaser's indemnification obligations. The Company incurred a loss of approximately $2.1 million on the sale including the $2.1 million of post-closing liabilities for which FriendFinder is obligated and a $336 thousand cumulative translation adjustment which was reclassified from accumulated other comprehensive loss, which is recorded as discontinued operations in the quarter ending September 30, 2012. The results of operations of the JigoCity locations were classified as discontinued operations in the accompanying 2012 consolidated statement of operations and for the nine month period ended September 30, 2012 resulted in a loss of approximately $13.6 million, including the loss on sale of $2.1 million and write-off of goodwill of $4.2 million and other assets, including intangibles, of $3.8 million attributable to such locations.

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13. Income Taxes

The Company records a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. As the Company anticipates that its net deferred tax assets at December 31, 2012 will be fully offset by a valuation allowance, no tax benefit has been recognized for the three and nine months ended September 30, 2012. The tax benefit for the three and nine months ended September 30, 2011 represents a reduction in the valuation allowance resulting from the recording of an approximately $5.7 million deferred tax liability related to a beneficial conversion feature which was charged to additional paid in capital.

14. Segment Information

The Company's reportable segments consist of Internet and Entertainment. For the nine months period ended September 30, 2011, the Entertainment Segment recorded revenue of $47,000 from advertising services provided to the Internet segment. Certain corporate expenses and interest expense are not allocated to segments. Segment assets include intangible, fixed, and all others identified with each segment. Unallocated corporate assets consist primarily of cash, certain prepaid items related to indebtedness and deferred tax assets not assigned to one of the segments.

Information for the Company's segments is as follows (in thousands):

	September 30, 2012	December 31, 2011
Assets:		
Internet	$ 445,779	$ 475,578
Entertainment	12,699	16,887
Unallocated corporate	3,703	899
Total	$ 462,181	$ 493,364

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenue from external customers:				
Internet	$ 72,699	$ 77,147	$ 223,624	$ 233,319
Entertainment	5,025	5,589	16,189	16,308
Total	$ 77,724	$ 82,736	$ 239,813	$ 249,627
Income from operations:				
Internet	$ 18,264	$ 16,926	$ 43,048	$ 59,619
Entertainment	208	(183)	209	(227)
Total segment income	$ 18,472	$ 16,743	$ 43,257	$ 59,392
Unallocated corporate	(1,487)	(2,032)	(5,141)	(7,011)
Total	$ 16,985	$ 14,711	$ 38,116	$ 52,381

For the three and nine months ended September 30, 2012 and 2011, included in income from operations are amortization of acquired intangibles and software of $3,707,000 and $4,060,000 and $11,120,000 and $11,906,000, respectively, and depreciation and other amortization of $800,000 and $913,000 and $2,361,000 and $3,268,000 respectively, all of which were incurred by the Internet segment.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

14. Segment Information (Continued)

Net revenues by service and product are as follows (in thousands):

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Internet:				
Subscription based service	$ 53,031	$ 56,290	$ 158,871	$ 172,511
Pay by usage service	19,668	20,708	64,753	60,660
Social Commerce	-	146	-	146
Advertising	-	2	-	2
	72,699	77,146	223,624	233,319
Entertainment				
Magazine	1,754	2,396	6,114	7,439
Video entertainment	2,747	2,630	8,455	7,223
Licensing	524	564	1,620	1,646
	5,025	5,590	16,189	16,308
Total revenue	$ 77,724	$ 82,736	$ 239,813	$ 249,627

The Company derives revenue from international websites and other foreign sources. Revenues by geographical area based on where the customer is located or the subscription originates are as follows (in thousands):

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net revenue:				
United States	$ 42,651	$ 47,201	$ 136,106	$ 136,874
Europe	21,902	26,261	62,137	70,538
Canada	4,147	5,183	13,292	14,042
Other	9,024	4,091	28,278	28,173
Total	$ 77,724	$ 82,736	$ 239,813	$ 249,627

Principally all long-lived assets are located in the United States.

15. Contingencies

On December 28, 2007, Broadstream Capital Partners, Inc. ("Broadstream") filed a lawsuit against the Company in the State Superior Court of California, County of Los Angeles, Central District, and the Company subsequently removed the case to the Federal District Court for the Central District of California. The complaint alleged breach of contract, breach of covenant of good faith and fair dealing, breach of fiduciary duty and constructive fraud arising out of a document titled "Non-Disclosure Agreement." The complaint sought damages in excess of $20 million, plus interest, costs and punitive damages. Broadstream later asserted up to $557 million in damages plus punitive damages. On July 20, 2009, the Company entered into an agreement with Broadstream under which, without admitting liability, the Company agreed to pay Broadstream $3.0 million. Such payments were timely made. The agreement provided that upon the earlier of twelve months after the Company had securities registered under Section 12(b) of the Securities Exchange Act of 1934, as amended, or eighteen months after the effective date of the agreement, but not later than twelve months following such earlier date, Broadstream must choose either to (i) refile its complaint in Federal District Court provided that it first repay the Company the $3.0 million or (ii) demand arbitration. If Broadstream elected arbitration, the parties agreed that there would be an arbitration award to Broadstream of at least $10 million but not more than $47 million. Giving consideration to the limitation of the arbitration award in relation to damages sought in litigation, management had not concluded that it was probable that Broadstream would demand arbitration. Accordingly, no loss had been provided for as a result of entering into the agreement. In December 2010, Broadstream elected arbitration. Accordingly, at December 31, 2010, the Company recognized a loss in connection with the matter of $13.0 million. In July 2011, the Company entered into a settlement agreement with Broadstream pursuant to which the arbitration and related litigation and all claims asserted therein were dismissed and the Company agreed to pay Broadstream $15 million of which $8 million was paid in July 2011, $5 million was paid in September 2011 and $2 million was paid in January 2012. As a result of the settlement, the Company recognized an additional loss of $5 million in the quarter ended June 30, 2011, which is included in other non-operating expense, net.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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15. Contingencies (Continued)

On December 23, 2005, Robert Guccione ("Guccione") filed an action against the Company and some of its officers, among other defendants, in New York State Court for breach of contract, fraud, unjust enrichment, promissory estoppel, failure to pay severance and conspiracy to defraud. The amount of damages requested in the complaint against the Company is approximately $9.0 million and against the officers is in excess of $10.0 million. Guccione filed an amended complaint on June 5, 2007 to include additional claims relating to ownership of certain United Kingdom, Jersey and Guernsey trademarks and added as a party Penthouse Publications Limited, an entity with no current affiliation with the Company, as party plaintiff. Guccione filed a second amended complaint on December 14, 2007 adding General Media International, Inc. (an entity with no current affiliation with the Company) as party plaintiff and a new claim for inducement to breach of contract. On October 20, 2010, Guccione passed away. In 2011, Guccione's estate was substituted as the plaintiff. In September, 2012 the parties executed a settlement agreement providing for both monetary and non-monetary relief, none of which is material. Such agreement will become final once accepted by the surrogate court presiding over Guccione's estate, which is anticipated before the end of 2012.

On November 28, 2006, Antor Media Corporation ("Antor") filed a complaint against the Company, its subsidiary, General Media Communications, Inc. ("GMCI"), and several non-affiliated media/entertainment defendants in the U.S. District Court for the Eastern District of Texas, Texarkana Division, for infringement of a Patent titled "Method and Apparatus for Transmitting Information Recorded on Information Storage Means from a Central Server to Subscribers via a High Data Rate Digital Telecommunications Network." In 2009, the USPTO issued a Final Office Action rejecting all of the plaintiff's claims and plaintiff appealed. In 2010, the USPTO Board of Patent Appeals entered an order affirming the rejection of Antor's claims. In May 2011, Antor filed its notice of appeal of the USPTO Board of Patent Appeals Order. In July 2012, the Federal Circuit affirmed the USPTO's rejection of all claims of Antor's patent-in-suit as being invalid over the prior art references cited during reexamination. The Federal Circuit issued its mandate affirming the decision of the USPTO on or about September 17, 2012.

Effective July 1, 2008, Various registered in the European Union and on July 29, 2008, began separately charging VAT to its customers. For periods prior thereto, Various recorded a liability for VAT and related interest and penalties in connection with revenue from internet services derived from its customers in the various European Union countries. Various reduced its VAT liability for periods prior to July 1, 2008 in the countries where the liability was either paid in full or payments were made pursuant to settlement and payment plans or where determinations were made that payments were not due. Various continues to negotiate settlements of the liabilities or challenge the liability related to VAT for periods prior to July 1, 2008.

On April 13, 2011, Facebook, Inc. ("Facebook") filed a complaint against the Company and certain of its subsidiaries in the U.S. District Court for the Northern District of California, alleging trademark infringement with regard to the use of the terms "face book of sex." The complaint contains causes of action for trademark dilution, false designation of origin, trademark infringement, violation of the Anti-Cybersquatting Consumer Protection Act, and for unfair competition. The complaint also seeks a declaratory judgment that Facebook's use of "friend finder" on its website is a descriptive fair use that does not infringe Various' trademark rights in the "FRIENDFINDER" mark. The Company filed a counterclaim against Facebook requesting injunctive relief, an accounting of Facebook's profits, and treble damages for injuries caused by Facebook's unauthorized use of "Friend Finder" in violation of the Lanham Act, and other federal and state violations. On February 14, 2012, as part of an amicable global resolution of the lawsuit, the matter was settled. All claims and counterclaims were dismissed on February 15, 2012. The Company paid an immaterial amount with respect to the settlement.

On November 11, 2011, a putative shareholder class action was filed in the U.S. District Court for the Southern District of Florida by Greenfield Children's Partnership, on behalf of investors who purchased the Company’s common stock pursuant to its initial public offering, against the Company, Ladenburg Thalmann & Co., Inc. and Imperial Capital LLC, the underwriters in the initial public offering, and the Company’s directors and certain of the Company’s executive officers. The complaint alleges, among other things, that the initial public offering documents contained certain false and misleading statements and seeks an unspecified amount of compensatory damages. In March 2012, the plaintiffs filed an amended complaint alleging all of the same causes of action and adding additional factual allegations and in response to the Amended Complaint the Company filed its Motion to Dismiss. The Company believes it has meritorious defenses to all claims and is vigorously defending the lawsuit.

FRIENDFINDER NETWORKS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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15. Contingencies (Continued)

The Company currently is a party to certain other legal proceedings and claims. While management presently believes that the ultimate outcome of these proceedings, including the ones discussed above, individually and in the aggregate, will not have a material adverse effect on the Company's financial position, cash flows, or overall trends in results of operations, litigation is subject to inherent uncertainties and unfavorable rulings could occur. An unfavorable ruling could include monetary damages or, in cases for which injunctive relief is sought, an injunction prohibiting the Company from selling one or more products or services. Were an unfavorable ruling to occur there exists the possibility of a material adverse impact on the business or results of operations for the period in which the ruling occurs or future periods. The Company is unable to estimate the possible loss or range of loss which may result from pending legal proceedings or claims.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 29, 2012. This Quarterly Report on Form 10-Q contains forward-looking statements, based on current expectations and related to future events and our future financial performance that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those set forth under the section entitled "Risk Factors" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 29, 2012 and elsewhere in this Quarterly Report on Form 10-Q.

Overview

We are a leading internet and technology company providing services in the rapidly expanding markets of social networking and web-based video sharing. Our business consists of creating and operating technology platforms which run several of the most heavily visited websites in the world. Through our extensive network of more than 55,000 websites, since our inception, we have built a base of more than 560 million registrants and more than 360 million members in more than 200 countries. We are able to create and maintain, in a cost-effective manner, websites intended to appeal to users of diverse cultures and interest groups. We offer our members a wide variety of online services so that they can interact with each other and access the content available on our websites. Our most heavily visited websites include AdultFriendFinder.com, Amigos.com, AsiaFriendFinder.com, Cams.com, FriendFinder.com, BigChurch.com and SeniorFriendFinder.com. For the three and nine months ended September 30, 2012, we had net revenue of $77.7 million and $239.8 million, respectively.

We operate in two segments, internet and entertainment. Our Internet Segment offers services and features that include social networking, online personals, premium content, live interactive video, recorded video, online chatrooms, instant messaging, photo, video and voice sharing, blogs, message board, and free e-mail. Our revenues to date have been primarily derived from online subscription and paid-usage for our Internet Segment products and services. Our market strategy is to grow this segment and expand our service offerings with complimentary services and features. Our Entertainment Segment produces and distributes original pictorial and video content, licenses the globally-recognized Penthouse brand to a variety of consumer product companies and entertainment venues and publishes branded men's lifestyle magazines. We continually seek to expand our licenses and products in new markets and retail categories both domestically and internationally.

Our History

Our predecessor company was incorporated in Delaware in 1993 under the name General Media, Inc., or GMI. GMI filed for bankruptcy on August 12, 2003 under Chapter 11 of the United States Bankruptcy Code and in September 2003, Marc H. Bell and Daniel C. Staton formed PET Capital Partners LLC, or PET, to acquire GMI's secured notes and preferred stock.

On October 5, 2004, GMI emerged from Chapter 11 protection with all new equity distributed solely to the holders of the GMI secured notes. The reorganized capital structure also included approximately $35.8 million of term loan notes (the "Term Loan Notes") distributed to former secured and unsecured creditors. Concurrently with the emergence from Chapter 11, we changed the name of the company to Penthouse Media Group Inc. and PET sold a minority position of non-voting Series B common stock to Interactive Brand Development Inc., or IBD.

During 2005, we consummated the sale of $33.0 million of 2005 Notes and $15.0 million of Series A Convertible Preferred Stock to fund the retirement of a $20.0 million credit facility, to fund the repayment of $11.8 million of the Term Loan Notes and to fund the purchase of certain trademark assets and for general corporate purposes. The remaining outstanding Term Loan Notes were reissued as subordinated term loan notes (the "Subordinated Term Loan Notes").

On March 31, 2006, we changed our state of incorporation from Delaware to Nevada.

On August 28, 2006, we consummated an offering of $5.0 million of 2006 Notes and $6.0 million of additional Series A Convertible Preferred Stock to fund the acquisition of substantially all of the assets of the debtor estate of Jill Kelly Productions, Inc., a production company, and for general corporate purposes.

On October 25, 2006, we acquired the outstanding shares of the Danni.com business, an adult internet content provider, for $1.4 million in cash and approximately 126,000 shares of common stock valued at $1.5 million, for which we issued an additional $0.9 million of Subordinated Term Loan Notes to fund part of the purchase price consideration.

In December 2007, we acquired Various for approximately $401.0 million. The purchase price of approximately $401.0 million paid to the sellers consisted of approximately (i) $137.0 million in cash, (ii) notes valued at approximately $248.0 million, and (iii) warrants to acquire approximately 2.9 million shares of common stock, subject to adjustment for certain anti-dilution provisions, valued at approximately $16.0 million. The purchase price gives effect to a $61.0 million reduction attributable to a post-closing working capital adjustment which resulted in a $51.0 million reduction in the value of notes issued and a $10.0 million reduction in cash paid which was held in escrow. This adjustment is the result of our indemnity claim against the sellers relating to the VAT liability. In addition, legal and other acquisition costs totaling approximately $4.0 million were incurred. The cash portion of the purchase price was obtained through the issuance of notes and warrants, including approximately $110.0 million from certain of our stockholders. On June 10, 2009, the United Kingdom taxing authority notified us that it had reversed its previous position and that we were not subject to VAT, which resulted in an approximately $39.5 million reduction in the VAT liability. On October 8, 2009, we settled all indemnity claims against the sellers (whether claims are VAT related or not) by adjusting the original principal amount of the Subordinated Convertible Notes to $156.0 million. In addition, the sellers agreed to make available to us, to pay VAT and certain VAT-related expenses, $10.0 million held in a working capital escrow account established at the closing of the Various transaction. As of December 31, 2010, a total of $10 million has been released from the escrow to reimburse us for VAT-related expenses already incurred. If the actual costs to us of eliminating the VAT liability are less than $29.0 million, after applying amounts from the working capital escrow, then the principal amount of the Non-Cash Pay Second Lien Notes (which were issued in exchange for the Subordinated Convertible Notes in the New Financing) will be increased by the issuance of new Non-Cash Pay Second Lien Notes to reflect the difference between $29.0 million and the actual VAT liability, plus interest on such difference.

In December 2007, we consummated an offering of $5.0 million of Series B Convertible Preferred Stock at a price of $0.59208 per share. The purchasers in the offering included certain current stockholders, including Messrs. Staton and Bell, Florescue Family Corporation, an entity affiliated with one of our former directors, Barry Florescue, and Absolute Income Fund Ltd. We used the proceeds from the Series B Convertible Preferred Stock offering to pay expenses relating to our acquisition of Various in December 2007 and for working capital. In July, 2008, we changed our name from Penthouse Media Group Inc. to FriendFinder Networks Inc.

On October 27, 2010, the Company completed the New Financing. The First Lien Senior Secured Notes, with an outstanding principal amount of $167.1 million, the Second Lien Subordinated Notes, with an outstanding principal amount of $80.0 million and $32.8 million principal amount of 2005 and 2006 Notes were exchanged for, or redeemed with proceeds of, $305.5 million principal amount of New First Lien Notes. The remaining $13.5 million principal amount of 2005 Notes and 2006 Notes were exchanged for $13.8 million principal amount of Cash Pay Second Lien Notes. The Subordinated Convertible Notes and Subordinated Term Loan Notes, with outstanding principal amounts of $180.2 million and $42.8 million respectively, together with accrued interest of $9.5 million, were exchanged for $232.5 million principal amount of Non-Cash Pay Second Lien Notes.

On May 16, 2011, the Company issued 5,000,000 shares of common stock at a price of $10.00 per share and completed its IPO. The Company raised gross proceeds of $50.0 million, less underwriting fees and commissions of 7.25% of the gross proceeds, or $3.6 million, and incurred other offering expenses of $2.9 million to be paid from the proceeds of the offering, resulting in $43.5 million of net proceeds. In addition, the Company had incurred and paid as of December 31, 2010, $13.3 million of offering costs, which were included in deferred offering costs in the accompanying balance sheet at December 31, 2010. The Company incurred an additional $3.0 million in offering costs during 2011 totaling $16.2 million which was transferred to paid in capital upon completion of the IPO.

On July 12, 2011, the Company acquired substantially all the assets of PerfectMatch.com from Matrima, Inc. for $2,000,000 in cash and $500,000 in common shares. PerfectMatch.com is an online relationship service helping adults seeking successful lasting connections.

On September 7, 2011, the Company acquired BDM Global Ventures Ltd., the company which owns the operations of JigoCity, for a combination of stock and warrants. The merger consideration consists of approximately 1.6 million shares of the Company’s common stock and approximately 6.4 million the Company’s warrants with exercise prices ranging from $5.00–$18.00 per share and is valued at approximately $7.5 million. JigoCity is a global social commerce organization committed to providing members with high quality daily deals that are relevant to their individual lifestyles.

On August 1, 2012, the Company sold all of the shares, par value $0.01 per share (the "Shares"), of JGC Holdings Limited ("JGC"), a British Virgin Islands Business Company, and a direct and wholly-owned subsidiary of the Company, that owns the operations of JigoCity to JGC Acquisition LLC (the "Purchaser"), an entity controlled by Anthony R. Bobulinski, the former owner of JigoCity. The Company sold the Shares for cash consideration in the amount of $1.00 and cancellation of warrants exercisable into 4,111,400 shares of common stock of the Company with exercise prices ranging from $7.00-$18.00 per share out of the warrants exercisable into 6,436,851 shares originally issued when the Company acquired the operations of JigoCity. Additionally, the Company will reimburse Purchaser up to an aggregate amount of $2.16 million for legitimate business expenses of the Purchaser or JGC for the time period from July 2012 through June 2013. The Purchaser has agreed to indemnify and hold harmless the Company and its affiliates in certain circumstances. As part of the sale transaction, 500,000 shares of common stock of the Company previously issued in connection with the Company's acquisition of JigoCity will remain in escrow until no later than December 31, 2012 to secure a guaranty by Global Investment Ventures, LLC, an entity wholly-owned by Mr. Bobulinski, of Purchaser's indemnification obligations.

Key Factors Affecting Our Results of Operations

Net Revenue

Our net revenue is affected primarily by the overall demand for online social networking and personals services. Our net revenue is also affected by our ability to deliver user content together with the services and features required by our users' diverse cultures, ethnicities and interest groups.

The level of our net revenue depends to a large degree on the growth of internet users, increased internet usage per user and demand for adult content. Our net revenue also depends on demand for credit card availability and the payment methods in countries in which we have registrants, members, subscribers and paid users, general economic conditions, and government regulation. The demand for entertainment and leisure activities tends to be highly sensitive to consumers' disposable incomes, and thus a decline in general economic conditions may lead to our current and potential registrants, members, subscribers and paid users having less discretionary income to spend. This could lead to a reduction in our revenue and have a material adverse effect on our operating results.

In addition, our net revenue could be impacted by foreign and domestic government laws that affect companies conducting business on the internet. Laws which may affect our operations relating to payment methods, including the use of credit cards, user privacy, freedom of expression, content, advertising, information security, internet obscenity and intellectual property rights are currently being considered for adoption by many countries throughout the world.

In the event that our monthly chargeback ratio and/or monthly reported fraud ratio exceeds the maximum prescribed by the card associations, we are subject to fines and penalties and have paid such fines and penalties over the last several months. In the event that such ratios do not come within the acceptable guidelines of card associations within a reasonable period of time, we will be subject to prescriptive action, including inability to process recurring transactions and elimination of affiliates directing members to our sites. See Risk Factor “Continued imposition of tighter processing restrictions by credit card companies and acquiring banks would make it more difficult to generate revenue from our websites” in the Company’s Form 10-K filed on March 29, 2012.

Internet Revenue

Approximately 93.5% and 93.2% of our net revenue for the three months ended September 30, 2012 and 2011, and 93.2% and 93.5% for the nine months ended September 30, 2012 and 2011, respectively, was generated from our Internet Segment comprised of social networking, live interactive video and premium content websites. This revenue is treated as service revenue in our financial statements. We derive our revenue primarily from subscription fees and pay-by-usage fees. These fees are charged in advance and recognized as revenue over the term of the subscription or as the advance payment is consumed on the pay-by-usage basis, which is usually immediately. VAT is presented on a net basis and is excluded from revenue.

Net revenue consists of all revenue net of credits back to customers for disputed charges and any chargeback expenses from credit card processing banks for such items as cancelled subscriptions, stolen cards and non-payment of cards. We estimate the amount of chargebacks and credits that will occur in future periods to offset current revenue. For the three and nine months ended September 30, 2012 and 2011, respectively, these credits and chargebacks were 5.9% and 5.6%, and 6.7% and 6.3% respectively, of gross revenue, while chargebacks alone were 1.6% and 1.2% and 2.1% and 1.3% respectively.

We believe that we have opportunities to substantially increase revenue by adding new features to our websites, expanding in foreign markets and generating third party advertising revenue from our internet websites, which allow us to target specific demographics and interest groups within our user base. However, our revenue growth rate may decline in the future as a result of increased penetration of our services over time and as a result of increased competition.

Entertainment Revenue

Approximately 6.5% and 6.8% of our net revenue for the three months ended September 30, 2012 and 2011, and 6.8% and 6.5% for the nine months ended September 30, 2012 and 2011 respectively, was generated by the Entertainment Segment. Entertainment revenue consists of studio production and distribution, licensing of the Penthouse name, logos, trademarks and artwork for the manufacture, sale and distribution of consumer products and publishing revenue. This revenue is treated as product revenue in our financial statements, with the exception of revenue derived from licensing, which is treated as service revenue. For more information regarding our net revenue by service and product, see Note 14, “Segment Information” of our condensed consolidated financial statements included elsewhere in this 10-Q. We derive revenue through third party license agreements for the distribution of our programming where we either receive a percentage of revenue or a fixed fee.

The revenue sharing arrangements are usually either a percentage of the subscription fee paid by the customer or a percentage of single program or title fee purchased by the customer. Our fixed fee contracts may receive a fixed amount of revenue per title, group of titles or for a certain amount of programming during a period of time. Revenue from the sale of magazines at newsstands is recognized on the on-sale date of each issue based on an estimate of the total sell through, net of estimated returns. The amount of estimated revenue is adjusted in subsequent periods as sales and returns information becomes available. Revenue from the sale of magazine subscriptions is recognized ratably over their respective terms.

Cost of Revenue

Cost of revenue for the Internet Segment is primarily comprised of commissions, which are expensed as incurred, paid to our affiliate websites and revenue shares for online models and studios in connection with our live interactive video websites. We estimate that cost of revenue will decrease as a percentage of net revenue primarily due to improvement in our affiliate commission structure and revenue sharing arrangements with our models and studios as net revenue increases. Cost of revenue for the Entertainment Segment consists primarily of publishing costs including costs of printing and distributing magazines and studio costs which principally consist of the cost of the production of videos. These costs are capitalized and amortized over three years which represents the estimated period during which substantially all the revenue from the content will be realized.

Marketing Affiliates

Our marketing affiliates are companies that operate websites that market our services on their websites and direct visitor traffic to our websites by placing banners or links on their websites to one or more of our websites.

The total net revenues derived from these marketing affiliates have decreased from year to year during the periods shown, while the percentage of revenue contribution has increased. The compensation to affiliates can vary depending on whether an affiliate chooses to be compensated on a pay-per-order or revenue sharing basis. Under a pay-per-order agreement, we compensate an affiliate one-time for each new member that places an order. Under a revenue sharing agreement, we compensate the affiliate in perpetuity for as long as the member continues to renew their subscription. Depending on the longevity of the subscription, either of the two compensation methods can result in a higher expense to us. In addition, we occasionally modify the pay-per-order compensation amount as needed depending on the quality of the traffic sent by the affiliate, economic factors, competition and other criteria.

Our compensation to our marketing affiliates has decreased and the percentage of revenues from our marketing affiliates have increased modestly, reflecting the variability in the rate at which we compensate our marketing affiliates described above.

The percentage of revenues derived from these affiliates and the compensation to our affiliates for the three and nine months ended September 30, 2012 and 2011 are set forth below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Percentage of revenue contributed by affiliates	47%	45%	48%	46%
Compensation to affiliates (in millions)	$ 14.3	$ 17.2	$ 51.3	$ 47.9

Operating Expenses

Product Development

Product development expense consists of the costs incurred for maintaining the technical staff which are primarily comprised of engineering salaries related to the planning and post-implementation stages of our website development efforts. These costs also include amortization of the capitalized website costs attributable to the application development stage. We expect our product development expenses to remain stable as a percentage of revenue as we continue to develop new websites, services, content and features which will generate revenue in the future.

Selling and Marketing

Selling and marketing expenses consist principally of advertising costs, which we pay to companies that operate internet search engines for key word searches in order to generate traffic to our websites. Selling and marketing expenses also include salaries and incentive compensation for selling and marketing personnel and related costs such as public relations. Additionally, the Entertainment Segment includes certain nominal promotional publishing expenses. We believe that our selling and marketing expenses will remain relatively constant as a percentage of revenue as these expenses are relatively variable and within the discretion of management.

General and Administrative

General and administrative expenses relate primarily to our corporate personnel related costs, professional fees, occupancy, credit card processing fees and other overhead costs.

Stock Based Compensation

Based on the IPO price of $10.00 per share on May 11, 2011, stock-based compensation for the nine months ended September 30, 2012, was approximately $0.6 million. Of such amounts, a cumulative adjustment to compensation expense of approximately $2.0 million was recognized in May 2011 upon the completion of our IPO.

Amortization of Acquired Intangibles and Software

Amortization of acquired intangibles and software is primarily attributable to intangible assets and internal-use software from acquisitions. Identified intangibles and internal-use software resulting from acquisitions were recorded at the acquisition date fair value. The total fair value of these intangibles and internal-use software acquired from Various in 2007 was $182.5 million. The amortization periods vary from two to five years with the weighted average amortization period equaling approximately three years. We recognized amortization expense associated with these assets of $3.7 million and $4.1 million for the three months ended September 30, 2012 and 2011, and $11.1 million and $11.9 million for the nine months ended September 30, 2012 and 2011 respectively. If we acquire other businesses which results in us owning additional intangible assets, the amortization of any acquired intangible assets could cause our depreciation and amortization expense to increase as a percentage of net revenue.

Depreciation and Other Amortization

Depreciation and other amortization is primarily depreciation expense on our computer equipment. We expect our depreciation and other amortization expenses to decrease due to purchases of new hardware and software associated with our growth plans increasing at a slower rate than our anticipated growth in net revenue.

Impairment of Goodwill and Other Intangible Assets

Impairment of goodwill and other intangible assets is recognized when we determine that the carrying value of goodwill and indefinite-lived intangible assets is greater than the fair value. We assess goodwill and other indefinite-lived intangibles at least annually, and more frequently when circumstances indicate that the carrying value may be impaired. We recorded goodwill impairment charges of $6.8 million in 2008 related to our Internet Segment and $2.8 million in 2008 related to our Entertainment Segment. In addition, we also recorded impairment charges related to our trademarks of $2.6 million, $4.7 million and $4.0 million in 2011, 2010 and 2009, respectively, related to our Entertainment Segment. Additionally, we have recorded a charge of $5.0 million from the write-off of goodwill and other intangible assets related to our discontinued JigoCity operations in 2012, which is recorded in Loss from Discontinued Operations.

Interest Expense, Net of Interest Income

Interest expense, net of interest income mainly represents interest expense recognized from the debt incurred in connection with the acquisition of Various and the New Financing and an increase in interest expense related to our debt incurred prior to the acquisition. Included in interest expense is amortization of note discounts due to certain warrants issued in connection with our 2005 Notes, 2006 Notes, First Lien Senior Secured Notes and Second Lien Subordinated Secured Notes and amortization of a discount to record the fair value of the Subordinated Convertible Notes at the date of issuance. As the exchange of such notes was not accounted for as extinguishment, subsequent to our debt restructuring on October 27, 2010, interest expense continues to include such amortization together with amortization of original issue discount related to our Senior Secured Notes and Cash Pay Notes and amortization of discount to record the fair value of certain Non-Cash Pay Notes at the date of issuance. Interest expense also includes amortization of deferred debt costs and the 2% and 10% premium paid in connection with payment of debt from excess cash flow each quarter.

Other Finance Expenses

Other finance expenses relates to charges incurred when we entered into Supplemental Indentures with the Trustee under the Company's New First Lien Notes and Cash-Pay Second Lien Notes, which was completed on March 27, 2012. These expenses were for third party fees related to the New First Lien Notes and Cash-Pay Second Lien Notes which were determined to be not substantially different than such notes prior to the modifications based on the less than 10% difference in present values of revised cash flows, including the consent fee, as compared with the remaining cash flows under the terms of the notes prior to modification and, accordingly, the modifications were accounted for as if the New First Lien Notes and Cash-Pay Second Lien Notes were not extinguished.

Interest and Penalties Related to VAT Liability not Charged to Customers

Interest and penalties related to VAT not charged to customers are due to our failure to file VAT tax returns and pay VAT based on the applicable law of each country in the European Union. Commencing in 2003, the member states of the European Union implemented rules requiring the collection and payment of VAT on revenues generated by non-European Union businesses that provide electronic services that are purchased by end users within the European Union. We did not begin collecting VAT from our subscribers until July 2008. At September 30, 2012 and December 31, 2011, the total amount of uncollected VAT payments was approximately $40.0 million and $41.0 million, respectively. For more information regarding our potential VAT liability, see Note 8 — "VAT Liabilities" in our condensed consolidated financial statements included elsewhere in this Form 10-Q. The majority of the penalties assessed by the various tax jurisdictions related to the VAT liability were incurred prior to our purchase of Various and thus charged back to the sellers by an offset in the principal amount of the Subordinated Convertible Notes held by the sellers. The portion of interest incurred prior to the purchase of Various was also charged back to the sellers by an offset in the principal amount of the Subordinated Convertible Notes held by the sellers, and subsequently continues to be recorded on the unpaid amounts. On October 14, 2008, we made an indemnity claim against these notes under the acquisition agreement for Various in the amount of $64.3 million. On June 10, 2009, the United Kingdom taxing authority notified us that it had reversed its previous position and that we were not subject to VAT, which resulted in an approximately $39.5 million reduction in the VAT liability. On October 8, 2009, we settled and released all indemnity claims against the sellers (whether claims are VAT related or not) by reducing the original principal amount of the Subordinated Convertible Notes by the full value of the then-outstanding VAT liability. In addition, the sellers agreed to make available to us, to pay VAT and certain VAT-related expenses, $10.0 million held in a working capital escrow account established at the closing of the Various transaction. As of December 1, 2010, the total $10.0 million had been released from the escrow to reimburse us for VAT-related expenses already incurred. If the actual costs to us of eliminating the VAT liability are less than $29.0 million, after applying amounts from the working capital escrow, then the principal amount of the Non-Cash Pay Notes (notes issued in exchange for the Subordinated Convertible Notes in the New Financing) will be increased by the issuance of new Non-Cash Pay Notes to reflect the difference between $29.0 million and the actual VAT liability, plus interest on such difference. For more information regarding the reductions of the principal amount of Subordinated Convertible Notes as a result of our VAT liability, see Note 8 — "VAT Liabilities".

Foreign Exchange Gain/(Loss), Principally Related to VAT Liability not Charged to Customers

Foreign exchange gain or loss principally related to VAT liability not charged to customers is the result of the fluctuation in the U.S. dollar against foreign currencies. We record a gain when the dollar strengthens against foreign currencies and a loss when the dollar weakens against those currencies. Our primary exposure to foreign fluctuations is related to the liability related to VAT not charged to customers, the majority of which is denominated in Euros.

Change in Fair Value of Acquisition Related Contingent Consideration

Change in fair value of acquisition related contingent consideration for the three and nine months ended September 30, 2012 was $0 and $1.4 million, respectively. In conjunction with the acquisition of JigoCity, a liability was recognized for an estimate of the acquisition date fair value of the related contingent consideration which may be paid. As of December 31, 2011, the fair value of this consideration was valued at $1.4 million, resulting in a credit to earnings of $1.4 million during the nine months ended September 30, 2012.

Gain on Liability Related to Warrants

Gain on liability related to warrants reflects our warrants issued in conjunction with the August 2005 issuance of the Senior Secured Notes. We issued warrants to purchase 501,663 shares of our common stock (of which 476,573 were exercisable at $6.20 per share and 25,090 were exercisable at $10.25 per share). The warrants contain a provision that required a reduction of the exercise price if certain equity events occur. Under the provisions of authoritative guidance that became effective for us on January 1, 2009, such a reset provision no longer makes the warrants eligible for equity classification and as such, effective January 1, 2009, we classified these warrants as a liability at a fair value of $6.3 million with a corresponding increase of $1.6 million to accumulated deficit and a $4.8 million reduction to capital in excess of par value. The liability is measured at fair value with changes in fair value reflected in the statement of operations.

In connection therewith, the statement of operations for the nine months ended September 30, 2011 reflects a gain of $391,000, on re-measurement of the liability. On May 16, 2011, concurrently with the consummation of the Company's IPO, warrants to issue 457,843 shares of common stock at $6.20 per share were net settled, whereby 174,246 shares of common stock were issued upon exercise, equivalent to the intrinsic value of the warrants based on the IPO price of $10 per share, and the Company did not receive any cash proceeds. In addition, warrants to acquire 24,104 common shares at $10.25 per share were terminated as they were not exercised. Accordingly, in May 2011, the liability related to the warrants was eliminated with the carrying value of $3,168,000 related to the exercised warrants transferred to capital in excess of par value and the carrying value of $119,000 related to the terminated warrants recorded as non-operating income. For further information, see "Note 10- Warrants" in our condensed consolidated financial statements included elsewhere in this Form 10-Q.

The Company's warrants were measured at fair value based on the binomial options pricing model using valuation inputs which are based on management's internal assumptions (which are not readily observable) at May 16, 2011 and December 31, 2010 respectively as follows: 1) dividend yield of 0% and 0%; 2) volatility of 43.2% and 43.3%, 3) risk-free interest rate of 2.3% and 1.9%; and 4) expected life of 4.25 years and 4.50 years.

Other Non-Operating Income/Expenses, Net

Other non-operating income and expenses include miscellaneous transactions not related to our primary operations. Included in the three and nine months ended September 30, 2011 is the settlement of our Broadstream arbitration case for $15 million, which required us to record an additional $5 million of expense. Also included in the nine months ended September 30, 2011 is life insurance proceeds related to the death of the original founder of Penthouse, Robert Guccione of $1.1 million. The remainder of the other expense in 2012 and 2011, respectively, was due mainly to miscellaneous gains and losses.

Income Tax

The Company records a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. As the Company anticipates that its net deferred tax assets at December 31, 2012 will be fully offset by a valuation allowance, no tax benefit has been recognized for the three and nine months ended September 30, 2012. The tax benefit in the three and nine months ended September 30, 2011 relates to a reduction in the valuation allowance resulting from the recording of an approximately $5.7 million deferred tax liability related to a beneficial conversion feature recognized in connection with our IPO.

At December 31, 2011, we had U.S. net operating loss carryforwards for federal income tax purposes of approximately $95.1 million available to offset future taxable income, which expire at various dates from 2024 through 2031. Our ability to utilize approximately $9.0 million of these carryforwards is limited due to changes in our ownership, as defined by federal tax regulations. In addition, utilization of the remainder of such carryforwards may be limited by the occurrence of certain further ownership changes. We also had net operating loss carryforwards in various foreign jurisdictions of approximately $1.8 million available to offset future taxable income, which expire at various dates.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect both the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and judgments are subject to an inherent degree of uncertainty. Our significant accounting policies are more fully described in Note C to our condensed consolidated financial statements contained in the Company's Form 10-K filed on March 29, 2012. However, certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations. In applying these critical accounting policies, our management uses its judgment in making certain assumptions to be used in making such estimates. Those estimates are based on our historical experience, the terms of existing contracts, our observation of trends in our industry and information available from other outside sources as appropriate. Accounting policies that, in their application to our business, involve the greatest amount of subjectivity by way of management judgments and estimates are those relating to valuation of goodwill, identified intangibles and other long-lived assets, including business combinations and legal contingencies.

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

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

- a significant decline in actual or projected revenue;
- 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;
- significant change in the manner of our use of acquired assets or the strategy for our overall business;
- a significant decrease in the market 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 and indefinite-lived 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 using a blended analysis of the present value of discounted cash flows and the market valuation approach. The discounted cash flow model uses the present values of estimated future cash flows. We use a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Considerable management judgment is necessary to evaluate the impact of operating and external economic factors in estimating our future cash flows. The assumptions we use in our evaluations include projections of growth rates and profitability, our estimated working capital needs, as well as our weighted average cost of capital. The market valuation approach indicates the fair value of a reporting unit based on a comparison to comparable publicly traded firms and acquired companies in similar businesses. Estimates used in the market value approach include the identification of similar companies with comparable business factors. Changes in economic and operating conditions impacting the assumptions we made could result in additional goodwill impairment in future periods. If the carrying value of a reporting unit exceeds its fair value, the goodwill of that reporting unit is potentially impaired. At this point we proceed to a step two analysis, wherein we measure the excess, if any, of the carrying value of a reporting unit's goodwill over its implied fair value, and record the impairment loss indicated.

Indefinite-lived intangible assets consist primarily of acquired domain names and trademarks. We measure the fair value of these assets using the relief from royalty method. This method assumes that the domain names and trademarks have value to the extent their owner is relieved from paying royalties for the benefits received. We estimate the future revenues for the associated names and trademarks, the appropriate royalty rate and the weighted average cost of capital.

During the nine months ended September 30, 2012, we wrote off $4.2 million of goodwill and $3.8 million of other assets, including intangibles, as a result of the closing and planned disposition of our JigoCity operations. Such write-offs were charged to discontinued operations.

We completed our annual impairment testing of goodwill, domain names, and trademarks as of December 2011, with the assistance of an independent valuation firm.

In 2011, 2010 and 2009, a trademark impairment loss of approximately $2.6 million, $4.7 million and $4.0 million, respectively, was recognized related to our Entertainment Segment. Such loss, which is included in impairment of other intangible assets in the 2011, 2010 and 2009 consolidated statement of operations, resulted due to the estimated fair value of certain trademarks being less than their carrying value. We had impairment charges related to goodwill of approximately $6.8 million in 2008 related to our Internet Segment and $2.8 million related to our Entertainment Segment in 2008. These losses were attributable to downward revisions of earnings forecasted for future years and an increase in the discount rate due to an increase in the perceived risk of our business prospects related to negative global economic conditions and increased competition.

In 2011, no impairment was found with respect to the goodwill of the Internet Segment. The analysis and assessment of the assets in this segment indicated that no impairment was required as the fair values exceeded the recorded carrying values. Although we believe our assumptions are reasonable, different assumptions or changes in the future may result in different conclusions and expose us to impairment charges in the future. The fair value of our Internet reporting units exceeded each of their carrying values by more than 100%. Given this large difference, very sizable changes would be needed to the assumptions in order for the carrying value to exceed fair value.

We have acquired the stock or specific assets of certain companies from 2006 through 2011 some of which were considered to be business acquisitions. Under the purchase method of accounting then in effect, the cost, including transaction costs, were 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 identifiable net assets acquired was recorded as goodwill.

Intangible assets which resulted from the acquisition were recorded at estimated fair value at the date of acquisition. Identifiable intangible assets are comprised mainly of studio and service contracts, domain names, customer lists and a non-compete agreement. In addition, purchase accounting requires deferred revenue be restated to estimated cost incurred to service the liability in the future, plus a reasonable margin.

The judgments made in determining the estimated fair value of assets and liabilities acquired and the expected useful life assigned to each class of assets can significantly impact net income.

As with the annual testing described above, determining the fair value of certain assets and liabilities acquired is subjective in nature and often involves the use of significant estimates and assumptions.

In our impairment testing, our forecasts of future performance, the discount rates used in discounted cash flow analysis and comparable Company comparisons are all subjective in nature and a change in one or more of the factors could have a material change in the results of such testing and our financial results.

Legal Contingencies

We are currently involved in certain legal proceedings, as discussed in Note 15 to our condensed consolidated financial statements. To the extent that a loss related to a contingency is probable and can reasonably be estimated, we accrue an estimate of that loss. Because of the uncertainties related to both the amount or range of loss on certain pending litigation and arbitration, we may be unable to make a reasonable estimate of the liability that could result from an unfavorable outcome of such matters. As additional information becomes available, we will assess the potential liability related to our pending matters and make, or if necessary revise, our estimates. Such changes in our estimates of the potential liability could materially impact our results of operations and financial position.

Segment Information

We divide our business into two reportable segments: internet, which consists of social networking, live interactive video and premium content websites; and entertainment, which consists of studio production and distribution, licensing and publishing. Certain corporate expenses are not allocated to segments. The following table presents our results of operations for the periods indicated for our reportable segments:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenue				
Internet	$ 72,699	$ 77,147	$ 223,624	$ 233,319
Entertainment	5,025	5,589	16,189	16,308
Total	77,724	82,736	239,813	249,627
Cost of revenue				
Internet	22,141	24,265	74,904	68,547
Entertainment	3,519	3,648	11,469	11,259
Total	25,660	27,913	86,373	79,806

Gross profit				
Internet	50,558	52,882	148,720	164,772
Entertainment	1,506	1,941	4,720	5,049
Total	52,064	54,823	153,440	169,821
Income (loss) from operations				
Internet	18,264	16,926	43,048	59,619
Entertainment	208	(183)	209	(227)
Unallocated corporate	(1,487)	(2,032)	(5,141)	(7,011)
Total	$ 16,985	$ 14,711	$ 38,116	$ 52,381

Internet Segment Historical Operating Data

The following table presents certain key business metrics for our adult websites, general audience websites and live interactive video websites for the three and nine months ended September 30, 2012 and 2011.

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Adult Websites				
New members	7,777,820	9,812,584	25,981,960	28,963,082
Beginning subscribers	794,680	857,733	827,728	950,705
New subscribers	383,374	406,261	1,210,680	1,210,247
Terminations	414,662	414,325	1,275,016	1,311,283
Ending subscribers	763,392	849,669	763,392	849,669
Conversion of members to subscribers	4.9%	4.1%	4.7%	4.2%
Churn	17.7%	16.2%	17.8%	16.2%
ARPU	$ 22.16	$ 20.86	$ 21.46	$ 20.24
CPGA	$ 40.16	$ 45.21	$ 46.35	$ 43.55
Average lifetime net revenue per subscriber	$ 84.75	$ 83.76	$ 74.17	$ 81.51
Net revenue (in millions)	$ 51.8	$ 53.4	$ 153.7	$ 164.0
General Audience Websites				
New members	888,129	1,463,706	3,010,530	5,050,758
Beginning subscribers	38,611	48,411	44,519	53,194
New subscribers	18,915	25,710	65,693	75,727
Terminations	19,461	27,785	72,147	82,585
Ending subscribers	38,065	46,336	38,065	46,336
Conversion of members to subscribers	2.1%	1.8%	2.2%	1.5%
Churn	16.9%	19.6%	19.4%	18.4%
ARPU	$ 11.18	$ 21.69	$ 13.91	$ 19.47
CPGA	$ 24.08	$ 30.10	$ 40.53	$ 26.83
Average lifetime net revenue per subscriber	$ 42.01	$ 80.86	$ 31.14	$ 78.75
Net revenue (in millions)	$ 1.3	$ 3.1	$ 5.2	$ 8.7
Live Interactive Video Websites				
Total minutes	8,989,717	8,781,261	27,893,863	25,991,342
Average revenue per minute	$ 2.18	$ 2.36	$ 2.32	$ 2.33
Net revenue (in millions)	$ 19.6	$ 20.7	$ 64.7	$ 60.7

New subscribers are subscribers who have paid subscription fees to one of our websites during the period indicated in the table but who were not subscribers in the immediately prior period. Members who previously were subscribers, but discontinued their subscriptions either by notifying us of their decisions to discontinue or allowing their subscriptions to lapse by failing to pay their subscription fees, are considered new subscribers when they become subscribers again at any point after their previous subscriptions ended. If a current subscriber to one of our websites becomes a subscriber to another one of our websites, such new subscription would also be counted as a new subscriber since such subscriber would be paying the full subscription fee for each subscription.

The table above includes the average lifetime net revenue per subscriber and the number of subscribers for the periods shown. While we monitor many statistics in the overall management of our business, we believe that average lifetime net revenue per subscriber and the number of subscribers are particularly helpful metrics for gaining a meaningful understanding of our business as they provide an indication of total revenue and profit generated from our base of subscribers inclusive of affiliate commissions and advertising costs required to generate new subscriptions.

While we monitor trends in visitors, conversion rates of visitors to subscribers, or paid users, does not provide a meaningful understanding of our business. Our raw data of visitors is subject to duplicate entries from visitors using multiple user names and e-mail addresses or accessing our websites as a member on one website and as a subscriber on another website. We use statistically significant samples and measurements of visitor data that allow our management to make evaluations based on such data.

There is the possibility that a new subscriber reflected on the table above was either a discontinued or lapsed prior subscriber or is also a current subscriber on a different FriendFinder website. We do not identify which subscribers were discontinued or lapsed subscribers or which subscribers are existing subscribers on a different FriendFinder website. Furthermore, a subscriber may come to one of our websites using multiple user names, e-mail addresses or credit cards, and consequently might be double counted. We do not quantify the number of new subscribers attributable to the sources listed above because we believe our current method provides the most relevant measurement of our business.

Churn is the most direct measurement of the value our subscribers get for the price we charge. We strive to provide our subscribers with a positive user experience, minimize technical difficulties and provide a competitively priced service. Our activities and efforts seek to lower churn rates as much as possible. Churn is calculated by dividing the quotient of terminations in the period over the average subscribers for the period by the number of months in the period.

With respect to our live interactive video websites, our goal is to maximize the number of minutes purchased and the revenue from those purchased minutes. Paid users are a subset of our members, and may also be subscribers on one or more of our other websites, who purchase products or services on a pay-by-usage basis on our live interactive video websites. The number of paid users is less important than the number and cost of the minutes purchased. Thus, we monitor the revenue from paid users, the number of minutes purchased in any period and the average value of the minutes purchased, all of which are presented in the table above. Minutes are based on the number of per-minute charges applied to paid users accounts.

Our results of operations related to our adult and general audience websites, as distinguished from the live interactive video websites discussed above, reflects the interaction of the conversion of members to subscribers, the churn of subscribers, and the average value of purchased products and services. A negative movement in any one of these items may be offset by a positive movement in another. For more information see the sections in this Form 10-Q entitled "— Results of Operations — Internet Segment Historical Operating Data for the Three Months Ended September 30, 2012 as Compared to the Three Months Ended September 30, 2011" and " - Results of Operations – Internet Segment Historical Operating Data for the Nine Months Ended September 30, 2012 as Compared to the Nine Months Ended September 30, 2011."

Results of Operations

Segments and Periods Presented

We operate in two segments, internet and entertainment. Our strategy is largely focused on the expansion of our Internet Segment. As a result, we expect our Entertainment Segment to become a decreasing percentage of our total net revenues. We expect our Entertainment Segment to continue to account for less than 10.0% and 5.0% of our net revenue and gross profit, respectively, for the next five years.

Our Entertainment Segment has higher fixed and variable costs associated with the business resulting in historically lower gross profit margins than our Internet Segment. We expect gross profit margins in our Entertainment Segment to continue to vary but remain within its historical range. We expect the internet gross profit percentage in future years to be consistent with the gross profit percentage in 2011.

We have provided a discussion of our results of operations on a consolidated basis and have also provided certain detailed discussions for each of our segments. In order to provide a meaningful discussion of our ongoing business, we have provided a discussion of the following:

- our consolidated results of operations for the three months ended September 30, 2012 compared to the three months ended September 30, 2011; and for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011.

- an analysis of Internet Segment operating data which are key to an understanding of our operating results and strategies for the three months ended September 30, 2012 as compared to three months ended September 30, 2011 and for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	33.0	33.7	36.0	32.0
Gross profit	67.0	66.3	64.0	68.0
Operating expenses:				
Product development	3.1	4.9	4.5	4.8
Selling and marketing	8.2	10.0	10.5	9.1
General and administrative	28.1	27.6	27.5	27.0
Amortization of acquired intangibles and software	4.8	4.9	4.6	4.8
Depreciation and other amortization	1.0	1.1	1.0	1.3
Total operating expenses	45.2	48.5	48.1	47.0
Income from operations	21.8	17.8	15.9	21.0
Interest expense, net of interest income	(28.4)	(25.5)	(26.8)	(26.1)
Interest and penalty related to VAT liability not charged to customers	(0.3)	(0.6)	(0.4)	(0.6)
Other finance expenses	-	-	(0.2)	-
Foreign exchange (loss) gain principally related to VAT liability not charged to customers	(0.6)	1.7	0.2	(0.6)
Gain on liability related to warrants	-	-	-	0.2
Loss on extinguishment of debt	-	-	-	(2.9)
Change in fair value of acquisition related contingent consideration	-	-	0.6	-
Other non-operating (expense) income, net	0.2	0.0	0.2	(1.6)
Loss before income tax (benefit) provision	(7.3)	(6.6)	(10.9)	(10.6)
Income tax (benefit) provision	-	(0.1)	-	(2.2)
Net loss from continuing operations	(7.3)	(6.5)	(10.9)	(8.4)
Loss from discontinued operations, net of tax	(2.7)	-	(5.7)	-
Net Loss:	(10.0)	(6.5)	(16.6)	(8.4)
Foreign Currency Translation Adjustment:	-	-	-	-
Comprehensive Loss:	(10.0)%	(6.5)	(16.6)	(8.4)%

Three Months Ended September 30, 2012 as Compared to the Three Months Ended September 30, 2011

Net Revenue. Net revenue for the three months ended September 30, 2012 and 2011 was $77.7 million and $82.7 million, respectively, representing a decrease of $5.0 million or 6.1%. Internet revenue for the three months ended September 30, 2012 and 2011 was $72.7 million and $77.1 million, respectively, representing a decrease of $4.4 million or 5.7%. Entertainment revenue for the three months ended September 30, 2012 and 2011 was $5.0 million and $5.6 million, respectively, representing a decrease of $0.6 million or 10.7%.

The decrease in internet revenue was primarily attributable to a decrease in our subscription based service revenue of $3.43 million, or 7.1% due to a decrease in affiliate based traffic to our websites as well as an increase in churn of our subscribers as described below in our cost of revenue and operating metrics respectively. The reduction in affiliate based traffic is a result of our efforts to eliminate certain low margin co-brands. We also experienced negative global economic conditions (including, but not limited to, an increase in credit card companies denying transactions) which affected our revenue as well.

Internet revenue for the three months ended September 30, 2012 was comprised of 71.2% relating to our social networking websites, 27.1% relating to our live interactive video websites and 1.8% relating to our premium content websites, as compared to 71.4% for our social networking websites, 26.9% for our live interactive video websites and 1.7% for our premium content websites for the same period in 2011.

The decrease in entertainment revenue was primarily due to a decrease in our publishing revenue of $0.6 million related to a decline in the number of magazines sold from 1.6 million to 1.5 million issues. The above was partially offset by an increase in our video entertainment revenue of $0.1 million as a result of expanded broadcast operations in Europe.

Entertainment revenue for the three months ended September 30, 2012 was comprised of 34.9% relating to magazine publishing, 54.7% relating to video entertainment and 10.4% relating to licensing, as compared to 42.9% for magazine publishing, 47.0% for video entertainment and 10.1% for licensing for the same period in 2011.

Cost of Revenue. Cost of revenue for the three months ended September 30, 2012 and 2011 was $25.7 million and $27.9 million, respectively, representing a decrease of $2.2 million or 7.9%. The decrease was primarily driven by a decrease in our affiliate commissions of $2.9 million.

Operating Expenses

Product Development. Product development expense for the three months ended September 30, 2012 and 2011 was $2.4 million and $4.0 million, respectively, representing a decrease of $1.6 million or 40.0%. The primary reason for the decrease in product and development expense was due to the reductions in overhead, including headcount reductions, announced earlier in the year.

Selling and Marketing. Selling and marketing expense for the three months ended September 30, 2012 and 2011 was $6.4 million and $8.3 million, respectively, representing a decrease of $1.9 million or 22.9%. The decrease in selling and marketing expense was primarily due to a $0.3 million decrease in our ad buy expenses over the period, from $5.3 million for the three months ended September 30, 2011 to $5.0 million for the same period in 2012. The largest single sales and marketing expense item is our ad buy expense, the cost of purchasing key word searches from major search engines.

General and Administrative. General and administrative expense for the three months ended September 30, 2012 and 2011 was $21.7 million and $22.8 million, respectively, representing a decrease of $1.1 million or 4.8%. The decrease in general and administrative expense was primarily due to a $3.5 million reduction in salaries, wages and benefits. We began to realize the cost savings from our previously announced headcount reductions. These decreases were partly offset by an increase of $1.7 million in merchant fees, mostly related to penalties paid to Visa for excessive chargebacks.

Amortization of Acquired Intangibles and Software. Amortization of acquired intangibles and software for the three months ended September 30, 2012 and 2011 was $3.7 and $4.1 million, respectively. The decrease was primarily due to a portion of the acquired intangibles becoming fully amortized. We have had no significant acquisitions since we acquired Various, Inc. on December 6, 2007.

Depreciation and Other Amortization. Depreciation and other amortization expense for the three months ended September 30, 2012 and 2011 was $0.8 million and $0.9 million, respectively. We continue to purchase additional fixed assets, while certain of our assets are becoming fully depreciated.

Interest Expense, Net of Interest Income. Interest expense for the three months ended September 30, 2012 and 2011 was $22.1 million and $21.1 million, respectively, representing an increase of $1.0 million or 4.7%. The increase was primarily due to the accrual of PIK interest on our Non-Cash Pay Second Lien Notes.

Interest and Penalties Related to VAT Liability not Charged to Customers. Effective July 1, 2003, as a result of a change in the law in the European Union, VAT was required to be collected from customers in connection with their use of internet services in the European Union countries. A provision and related liability have been record for interest and penalties related to VAT not charged to customers and failure to file tax returns based on the applicable law of each relevant country in the European Union.

Interest related to VAT liability not charged to customers for the three months ended September 30, 2012 and 2011 was $0.3 million and $0.5 million, respectively. We continue to record interest expense in the applicable unsettled European Union countries in which we have an estimated $20.5 million of unremitted VAT liability as of September 30, 2012.

Foreign Exchange Gain/(Loss) Principally Related to VAT Liability not Charged to Customers. Foreign exchange loss principally related to VAT not charged to customers for the three months ended September 30, 2012 was $0.5 million as compared to a gain of $1.4 million for the three months ended September 30, 2011. The loss for the three months ended September 30, 2012 is primarily related to the increase in the U.S. dollar amount of the VAT liability assumed from Various which was denominated in Euros due to the weakening of the U.S. dollar in relation to the Euro. The gain for the three months ended September 30, 2011 is due to the strengthening of the U.S. dollar.

Other Non-operating Expense, Net. Other non-operating expense for the three months ended September 30, 2012 and 2011 was $0.1 million and $0.0 million, respectively. The expenses in 2012 were due mainly to miscellaneous gains and losses.

Income Tax Benefit. Income tax benefit for the three months ended September 30, 2012 was $0.0 million as compared to a benefit of $0.1 million for the same period in 2011. The tax benefit in the three month period ended September 30, 2011, relates to a reduction in the valuation allowance resulting from the recording of an approximately $5.7 million deferred tax liability related to a beneficial conversion feature which was charged to additional paid-in capital in the three month period ended September 30, 2011. No tax benefit was recorded for the three months ended September 30, 2012, as the Company anticipates that its net deferred tax assets at December 31, 2012 will be fully offset by a valuation allowance.

Loss on Discontinued Operations. In the third quarter of 2012, the Company sold its JigoCity operations. As such, an additional loss for discontinued operations was recognized, including $2.1 million of post-closing liabilities related to the sale of the JigoCity operations.

Net Loss. Net loss for the three months ended September 30, 2012 and 2011 was $7.7 million and $5.4 million, respectively, representing an increase of $2.3 million or 42.6%. The loss in 2012 included a $2.1 million loss from Discontinued Operations from the JigoCity operations.

Nine Months Ended September 30, 2012 as Compared to the Nine Months Ended September 30, 2011

Net Revenue. Net revenue for the nine months ended September 30, 2012 and 2011 was $239.8 million and $249.6 million, respectively, representing a decrease of $9.8 million or 3.9%. Internet revenue for the nine months ended September 30, 2012 and 2011 was $223.6 million and $233.3 million, respectively, representing a decrease of $9.7 million or 4.2%. Entertainment revenue for the nine months ended September 30, 2012 and 2011 was $16.2 million and $16.3 million, respectively, representing a decrease of $0.1 million or 0.6%.

The decrease in internet revenue was primarily attributable to a decrease in our subscription based service revenue of $13.6 million, or 7.9% due to a decrease in traffic to our websites as well as an increase in churn of our subscribers as described below in our cost of revenue and operating metrics respectively. The above decline was offset by an increase in our live interactive video websites revenue of $4.1 million, or 6.8%, due mainly to an increase in total minutes purchased which was a direct result of more effective marketing campaigns. Negative global economic conditions (including, but not limited to, an increase in credit card companies denying transactions) affected our revenue as well.

Internet revenue for the nine months ended September 30, 2012 was comprised of 69.3% relating to our social networking websites, 29.0% relating to our live interactive video websites and 1.7% relating to our premium content websites, as compared to 72.3% for our social networking websites, 26.0% for our live interactive video websites and 1.6% for our premium content websites for the same period in 2011.

The decrease in entertainment revenue was primarily due to a decrease in our magazine revenue of $1.3 million as a result of a decline in the number of magazines sold from 2.4 million to 1.5 million issues.

Entertainment revenue for the nine months ended September 30, 2012 was comprised of 37.8% relating to magazine publishing, 52.2% relating to video entertainment and 10.0% relating to licensing, as compared to 45.6% for magazine publishing, 44.3% for video entertainment and 10.1% for licensing for the same period in 2011.

Cost of Revenue. Cost of revenue for the nine months ended September 30, 2012 and 2011 was $86.4 million and $79.8 million, respectively, representing an increase of $6.6 million or 8.3%. The increase was primarily driven by an increase in our affiliate commissions of $3.4 million due to increased levels of promotions and affiliate compensation.

Operating Expenses

Product Development. Product development expense for the nine months ended September 30, 2012 and 2011 was $10.7 million and $12.1 million, respectively, representing a decrease of $1.4 million or 11.7%. The primary reason for the decrease in product development expense was due to the reductions in overhead, including headcount reductions, announced earlier this year.

Selling and Marketing. Selling and marketing expense for the nine months ended September 30, 2012 and 2011 was $25.1 million and $22.7 million, respectively, representing an increase of $2.4 million or 10.6%. The increase in selling and marketing expense was primarily due to a $3.4 million increase in our ad buy expenses over the period, from $16.6 million for the nine months ended September 30, 2011 to $20.0 million for the same period in 2012. The largest single sales and marketing expense item is our ad buy expense, the cost of purchasing key word searches from major search engines.

General and Administrative. General and administrative expense for the nine months ended September 30, 2012 and 2011 was $66.1 million and $67.5 million, respectively, representing a decrease of $1.4 million or 2.1%. The above decrease was primarily driven by a $3.7 million reduction in legal fees and a $1.8 million reduction in stock compensation expense partially offset by a $4.5 million increase in merchant fees, mostly related to penalties paid to Visa for excessive chargebacks.

Amortization of Acquired Intangibles and Software. Amortization of acquired intangibles and software for the nine months ended September 30, 2012 and 2011 was $11.1 million and $11.9 million, respectively. The decrease was primarily due to a portion of the acquired intangibles becoming fully amortized. We have had no significant acquisitions since we acquired Various, Inc. on December 6, 2007.

Depreciation and Other Amortization. Depreciation and other amortization expense for the nine months ended September 30, 2012 and 2011 was $2.4 million and $3.3 million, respectively. We continue to purchase additional fixed assets, while certain of our assets are becoming fully depreciated.

Interest Expense, Net of Interest Income. Interest expense for the nine months ended September 30, 2012 and 2011 was $64.2 million and $65.1 million, respectively, representing a decrease of $0.9 million or 1.4%. The decrease was due mainly to debt payments.

Other Finance Expenses. Other finance expenses for the nine months ended September 30, 2012 were due to charges incurred when we entered into Supplemental Indentures with the Trustee under the Company's New First Lien Notes and Cash-Pay Second Lien Notes, which was completed on March 27, 2012. These expenses were for third party fees related to the New First Lien Notes and Cash-Pay Second Lien Notes which were determined to be not substantially different than such notes prior to the modifications based on the less than 10% difference in present values of revised cash flows, including the consent fee, as compared with the remaining cash flows under the terms of the notes prior to modification and, accordingly, the modifications were accounted for as if the New First Lien Notes and Cash-Pay Second Lien Notes were not extinguished. We had no such comparable costs in the same period for 2011.

Interest and Penalties Related to VAT Liability not Charged to Customers. Effective July 1, 2003, as a result of a change in the law in the European Union, VAT was required to be collected from customers in connection with their use of internet services in the European Union countries. A provision and related liability have been recorded for interest and penalties related to VAT not charged to customers and failure to file tax returns based on the applicable law of each relevant country in the European Union.

Interest related to VAT liability not charged to customers for the nine months ended September 30, 2012 was $1.0 million as compared to $1.4 million for the nine months ended September 30, 2011. The decrease in interest related to VAT not charged to customers is due to VAT settlements with additional countries. We continue to record interest expense in the applicable unsettled European Union countries in which we have an estimated $20.5 million of unremitted VAT liability as of September 30, 2012.

Foreign Exchange Gain/(Loss) Principally Related to VAT Liability not Charged to Customers. Foreign exchange gain principally related to VAT not charged to customers for the nine months ended September 30, 2012 was $0.5 million as compared to a loss of $1.5 million for the nine months ended September 30, 2011. The gain for the nine months ended September 30, 2012 is primarily related to the decrease in the U.S. dollar amount of the VAT liability assumed from Various which was denominated in Euros due to the strengthening of the U.S. dollar. The loss for the nine months ended September 30, 2011 is due to the weakening of the U.S. dollar.

Change in Fair Value of Acquisition Related Contingent Consideration. Gain on acquisition related contingent consideration for the nine months ended September 30, 2012 was $1.4 million. In conjunction with the acquisition of JigoCity, a liability was recognized for an estimate of the acquisition date fair value of the related contingent consideration which may be paid. As of September 30, 2012, the fair value of this consideration was considered to have no value resulting in an increase to earnings of $1.4 million.

Gain on Liability Related to Warrants. Gain on liability related to warrants for the nine months ended September 30, 2011 was $0.4 million. The liability related to the 501,663 warrants issued in August 2005 was established as a result of new authoritative guidance becoming effective for us as of January 1, 2009. For further information, see "Note 10 — Warrants" in our condensed consolidated financial statements included elsewhere in this form 10-Q. There was no gain on liability related to warrants for the nine months ended September 30, 2012.

Loss on Extinguishment of Debt: Loss on extinguishment of debt for the nine months ended September 30, 2011 was $7.3 million. This expense was related to write-off of deferred costs and discount and a prepayment penalty due to our redeeming approximately $37.8 million of New First Lien Notes and approximately $1.7 million of Cash Pay Second Lien Notes in connection with proceeds received from our IPO in May 2011. There was no loss on extinguishment of debt for the nine months ended September 30, 2012.

Other Non-operating Expense, Net. Other non-operating expense for the nine months ended September 30, 2012 was $0.5 million as compared to $3.9 million for the same period in 2011. The expense in 2011 was primarily due to our settlement of the Broadstream arbitration case for $15.0 million, which required us to record an additional $5.0 million of expense. For further information, see “Note 15—Contingencies” in our condensed consolidated financial statements included elsewhere in this form 10-Q. The above expense was offset with life insurance proceeds related to the death of the original founder of Penthouse, Robert Guccione in the amount of $1.1 million. The remainder of the other expense in 2012 and 2011, respectively, was due mainly to miscellaneous gains and losses.

Income Tax Benefit. Income tax benefit for the nine months ended September 30, 2011 was $5.5 million. The tax benefit in the nine month period ended September 30, 2011, relates to a reduction in the valuation allowance resulting from the recording of an approximately $5.7 million deferred tax liability related to a beneficial conversion feature which was charged to additional paid-in capital in the nine month period ended September 30, 2011. A larger tax benefit related to pre-tax loss was not recognized for the nine months ended September 30, 2011 due to an anticipated increase in the valuation allowance against deferred tax assets at year end. There was no Income Tax Benefit for the nine months ended September 30, 2012 as the Company anticipates its net deferred tax assets at December 31, 2012 will be fully offset by a valuation allowance.

Loss from Discontinued Operations. During the first quarter of 2012, the Company began procedures to streamline its operations and announced that certain units within the JigoCity subsidiary would be terminated effective March 31, 2012. As a result of this decision, the Company recognized for the three months ended March 31, 2012, a loss from discontinued operations of approximately $8.1 million including $6.2 million of write-offs related to the closure of the Company's Shanghai, Singapore, Hong Kong, Malaysia and Australia offices. In the third quarter of 2012, the Company sold its JigoCity operations. As such, an additional loss for discontinued operations was recognized, including $2.1 million of post-closing liabilities related to the sale of the JigoCity operations.

Net Loss. Net loss for the nine months ended September 30, 2012 and 2011 was $39.8 million and $20.9 million, respectively, representing an increase of $18.9 million. The larger loss in 2012 was primarily due to a $13.6 million loss from Discontinued Operations related to JigoCity.

Internet Segment Historical Operating Data for the Three Months Ended September 30, 2012 as Compared to the Three Months Ended September 30, 2011

Adult Websites

Subscribers. Subscribers for the three months ended September 30, 2012 were 763,392 as compared to 849,669 for the three months ended September 30, 2011, representing a decrease of 86,277 or 10.2%. The decrease was primarily driven by the increase in churn described below.

Churn. Churn for the three months ended September 30, 2012 was 17.7% as compared to 16.2% for the three months ended September 30, 2011 representing an increase of 150 basis points, or 9.3%. Churn is the most direct measurement of the value our subscribers get for the price we charge. We strive to provide our subscribers with a positive user experience, minimize technical difficulties and provide a competitively priced service. Our activities and efforts seek to lower churn rates as much as possible.

Average Revenue per Subscriber. ARPU for the three months ended September 30, 2012 was $22.16 as compared to $20.86 for the three months ended September 30, 2011, representing an increase of $1.30, or 6.2%.

Cost Per Gross Addition. CPGA for the three months ended September 30, 2012 was $40.16 as compared to $45.21 for the three months ended September 30, 2011, representing a decrease of $5.05 or 11.2%. The decrease was primarily driven by a decrease in our affiliate expense on our adult websites from $14.5 million in the three months ended September 30, 2011 to $12.3 million in the three months ended September 30, 2012.

Average Lifetime Net Revenue Per Subscriber. Average Lifetime Net Revenue Per Subscriber for the three months ended September 30, 2012 was $84.75 as compared to $83.76 for the three months ended September 30, 2011, representing an increase of $0.99 or 1.2%. The increase was driven by the increase in ARPU and decrease in CPGA described above.

General Audience Websites

Subscribers. Subscribers for the three months ended September 30, 2012 were 38,065 as compared to 46,336 for the three months ended September 30, 2011, representing a decrease of 8,271 or 17.9%. The decrease was primarily driven by the decrease in new member traffic.

Churn. Churn for the three months ended September 30, 2012 was 16.9% as compared to 19.6% for the three months ended September 30, 2011, representing a decrease of 270 basis points, or 13.5%. Churn is the most direct measurement of the value our subscribers get for the price we charge. We strive to provide our subscribers with a positive user experience, minimize technical difficulties and provide a competitively priced service. Our activities and efforts seek to lower churn rates as much as possible.

Average Revenue per Subscriber. ARPU for the three months ended September 30, 2012 was $11.18 as compared to $21.69 for the three months ended September 30, 2011, representing a decrease of $10.51 or 48.4%. The primary reason for the decrease was change in pricing plans.

Cost Per Gross Addition. CPGA for the three months ended September 30, 2012 was $24.08 as compared to $30.10 for the three months ended September 30, 2011, representing a decrease of $6.02 or 20%. The decrease was primarily driven by a decrease in our affiliate commission expense from $0.5 million for the three months ended September 30, 2011 to $0.2 million for the three months ended September 30, 2012.

Average Lifetime Net Revenue Per Subscriber. Average Lifetime Net Revenue Per Subscriber for the three months ended September 30, 2012 was $42.01 as compared to $80.86 for the three months ended September 30, 2011, representing a decrease of $38.84 or 48.0%. The decrease was primarily driven by the decrease in ARPU described above.

Live Interactive Video Websites

Average Revenue Per Minute. Average Revenue Per Minute for the three months ended September 30, 2012 was $2.18 as compared to $2.36 for the three months ended September 30, 2011, representing a decrease of $0.17 or 7.4%.

Total Purchased Minutes. Total purchased minutes for the three months ended September 30, 2012 were 9.0 million as compared to 8.8 million for the three months ended September 30, 2011, representing an increase of 0.2 million or 2.4%. The primary reason for the increase in purchased minutes was an increase in new members and minutes purchased per member.

Internet Segment Historical Operating Data for the Nine Months Ended September 30, 2012 as Compared to the Nine Months Ended September 30, 2011

Adult Websites

Subscribers. Subscribers for the nine months ended September 30, 2012 were 763,392 as compared to 849,669 for the nine months ended September 30, 2011, representing a decrease of 86,277 or 10.2%. The decrease was primarily driven by the increase in churn described below.

Churn. Churn for the nine months ended September 30, 2012 was 17.8% compared to 16.2% for the nine months ended September 30, 2011, representing an increase of 160 basis points, or 10.0%. Churn is the most direct measurement of the value our subscribers get for the price we charge. We strive to provide our subscribers with a positive user experience, minimize technical difficulties and provide a competitively priced service. Our activities and efforts seek to lower churn rates as much as possible.

Average Revenue per Subscriber. ARPU for the nine months ended September 30, 2012 was $21.46 as compared to $20.24 for the nine months ended September 30, 2011, representing an increase of $1.22, or 6.0%.

Cost Per Gross Addition. CPGA for the nine months ended September 30, 2012 was $46.35 as compared to $43.55 for the nine months ended September 30, 2011, representing an increase of $2.80 or 6.4%. The increase was primarily driven by an increase in our affiliate expense on our adult websites from $40.4 million in the nine months ended September 30, 2011 to $43.4 million in the nine months ended September 30, 2012.

Average Lifetime Net Revenue Per Subscriber. Average Lifetime Net Revenue Per Subscriber for the nine months ended September 30, 2012 was $74.17 as compared to $81.51 for the nine months ended September 30, 2011, representing a decrease of $7.34 or 9.0%. The decrease was driven by an increase in the churn and CPGA described above.

General Audience Websites

Subscribers. Subscribers for the nine months ended September 30, 2012 were 38,065 as compared to 46,336 for the nine months ended September 30, 2011, representing a decrease of 8,271 or 17.85%. The decrease was primarily driven by the decrease in new member traffic and the increase in churn described below.

Churn. Churn for the nine months ended September 30, 2012 was 19.4% as compared to 18.4% for the nine months ended September 30, 2011, representing an increase of 100 basis points, or 5.3%. Churn is the most direct measurement of the value our subscribers get for the price we charge. We strive to provide our subscribers with a positive user experience, minimize technical difficulties and provide a competitively priced service. Our activities and efforts seek to lower churn rates as much as possible.

Average Revenue per Subscriber. ARPU for the nine months ended September 30, 2012 was $13.91 as compared to $19.47 for the nine months ended September 30, 2011, representing a decrease of $5.55 or 28.5%. The primary reason for the decrease was a change in pricing plans.

Cost Per Gross Addition. CPGA for the nine months ended September 30, 2012 was $40.53 as compared to $26.83 for the nine months ended September 30, 2011, representing an increase of $13.70 or 51.1%. The increase was primarily driven by an increase in our ad-buy expense from $0.6 million for the nine months ended September 30, 2011 to $1.8 million for the nine months ended September 30, 2012.

Average Lifetime Net Revenue Per Subscriber. Average Lifetime Net Revenue Per Subscriber for the nine months ended September 30, 2012 was $31.14 as compared to $78.75 for the nine months ended September 30, 2011, representing a decrease of $47.62 or 60.5%. The decrease was primarily driven by the increase in churn and CPGA and decrease in ARPU described above.

Live Interactive Video Websites

Average Revenue Per Minute. Average Revenue Per Minute for the nine months ended September 30, 2012 was $2.32 as compared to $2.33 for the nine months ended September 30, 2011, representing a decrease of $0.01, or 0.6%.

Total Purchased Minutes. Total purchased minutes for the nine months ended September 30, 2012 were 27.9 million as compared to 26.0 million for the nine months ended September 30, 2011, representing an increase of 1.9 million or 7.3%. The primary reason for the increase in purchased minutes was an increase in new members and minutes purchased per member.

Non-GAAP Financial Measures

We believe that certain non-GAAP financial measures of earnings before deducting net interest expense, income taxes, depreciation and amortization, or EBITDA, and adjusted EBITDA are helpful financial measures to be utilized by an investor. First, they eliminate one-time adjustments made for accounting purposes in connection with our Various acquisition in order to provide information that is directly comparable to our historical and current financial statements. For more information regarding our acquisition of Various, please refer to the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Our History.” For example, our depreciation and amortization expense has changed significantly due to the Various acquisition and purchase accounting impact on depreciation and amortization expense, as discussed below. Second, they eliminate adjustments for non-cash impairment charges for goodwill and intangible assets, which we believe will help an investor evaluate our future prospects, without taking into account historical non-cash charges that we believe are not recurring. Finally, they allow the investor to measure our operating performance year over year without taking into account non-recurring items and the wide disparity in the amounts of the interest, depreciation and amortization and tax expense items set forth in the financial statements.

For instance, we are highly leveraged and we have had a large varying amount of interest expense. We used the proceeds from our IPO to repay a portion of our New First Lien Notes and Cash Pay Second Lien Notes, thereby reducing our interest expense (see “Note 9-Long Term Debt”), as well as incurring a loss on extinguishment of debt. Also in conjunction with our IPO, we were required to begin recording compensation expense related to our stock options. In addition, we have the benefit of interest deductions and tax loss carryforwards which distorts comparisons of income tax benefit from year to year as interest expense is reduced and tax carryforwards are depleted and we book an income tax expense as opposed to a benefit. We believe analysts, investors and others frequently use EBITDA and adjusted EBITDA in the evaluation of companies in our industry.

These non-GAAP financial measures may not provide information that is directly comparable to that provided by other companies in our industry, as other companies in our industry may calculate such financial measures differently, particularly as it relates to nonrecurring, unusual items. Our non-GAAP financial measures of EBITDA and adjusted EBITDA are not measurements of financial performance under GAAP and should not be considered as alternatives to cash flow from operating activities or as measures of liquidity or as alternatives to net income or as indications of operating performance or any other measure of performance derived in accordance with GAAP.

The following table reflects the reconciliation of GAAP net loss to the non-GAAP financial measures of EBITDA and adjusted EBITDA.

Reconciliation of GAAP Net Loss to EBITDA and Adjusted EBITDA

	Unaudited			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
GAAP net loss	$ (7,746)	$ (5,396)	$ (39,803)	$ (20,938)
Add: Interest expense, net	22,055	21,146	64,203	65,097
Add: Other finance expenses	-	-	500	-
Subtract: Income tax benefit	-	(82)	-	(5,542)
Add: Amortization of acquired intangible assets and software	3,707	4,060	11,120	11,906
Add: Depreciation and other amortization	800	913	2,361	3,268
EBITDA	$ 18,816	$ 20,641	$ 38,381	$ 53,791
Add: Broadstream arbitration provision, including related legal fees	-	-	-	7,394
Subtract/Add: (Gain)/Loss related to VAT liability not charged to customers	725	(956)	466	2,931
Add: Loss of extinguishment of debt	-	-	-	7,312
Add: Severance Expense	7	388	434	388
Add: Discontinued Operations	2,078	-	13,623	-
Add: Stock Compensation Expense	347	269	803	2,554
Subtract: Change in fair value of acquisition related contingent consideration	-	-	(1,400)	-
Add: Indenture Fee	500	-	500	-
Adjusted EBITDA(1)	$ 22,473	$ 20,342	$ 52,807	$ 74,370

(1) Our note agreements contain material debt covenants based on our maintaining specified levels of EBITDA (as it is defined in the particular agreement as noted below). Specifically, we are required to maintain the following EBITDA levels for our outstanding debt:

- For each of the fiscal quarters ending through September 30, 2011, September 30, 2012 and September 30, 2013, our EBITDA (as defined) on a consolidated basis for the four consecutive fiscal quarters ending on such dates needed, or needs, to be greater than $85 million, $90 million and $95 million, respectively. Our EBITDA for the four quarters ended December 31, 2011, as defined in the relevant documents, was $92.9 million. These levels were amended prospectively for the New First Lien Notes and the Cash Pay Second Lien Notes commencing the fiscal quarter ended March 31, 2012. For such period, and thereafter, for the period of any four consecutive fiscal quarters, Consolidated EBITDA shall not be less than $65 million through December 31, 2012, not less than $75 million through March 31, 2013, and not less than $80 million through June 30, 2013. Consolidated EBITDA for the fiscal quarter ending September 30, 2012 shall not be less than $16 million and the combined Consolidated EBITDA for the third and fourth fiscal quarters of 2012 (ending September 30, 2012 and December 31, 2012, respectively) shall not be less than $36 million. In addition, starting with the fiscal quarter ending March 31, 2013, the average of any two consecutive quarters going forward shall not be less than $20 million. Our EBITDA for the four quarters ended September 30, 2012 was $71.2 million and our EBITDA for the fiscal quarter ending September 30, 2012 was $22.5 million. The indenture governing the Non-Cash Second Lien Notes was not modified and as a result, as of the date of this filing, the Company did not comply with the minimum EBITDA requirement (as defined) of $90 million for the four consecutive fiscal quarters ended September 30, 2012. The Company's EBITDA was calculated for such period to be $71.2 million. In addition, for the third quarter of 2012, the Total Debt Ratio (as defined) of 7.1:1.0 was above the required maximum level of 6.1:1.0. Further, the Company during such period did not comply with other debt ratios and from time to time, the Company did not meet the minimum liquidity requirement of $10 million of Qualified Cash and did not meet the reporting requirement with respect thereto. Therefore, the Company is in default as of November 14, 2012 and the Non-Cash Pay Second Lien Notes are subject to the post-default interest rate of 15%. For more information regarding the default, see Footnote 9(d) – "Long-Term Debt." Under the terms of an Intercreditor and Subordination Agreement among the Trustees under the New First Lien Note Indenture, the Cash Pay Second Lien Note Indenture and the Non-Cash Pay Second Lien Indenture, neither the Trustee under the Non-Cash Pay Second Lien Indenture nor the holders of Non-Cash Pay Second Lien Notes may accelerate the Notes or take any other Enforcement Action (as defined) until the New First Lien Notes are paid in full. The Non-Cash Pay Second Lien Notes are classified as a non-current liability in the accompanying consolidated balance sheet at September 30, 2012.

- We met our EBITDA covenant requirements for the years ended December 31, 2010 and 2011.

For the three months ended September 30, 2012 and 2011, our EBITDA was $18.8 million and $20.6 million, respectively, and $38.4 million and $53.8 million for the nine months ended September 30, 2012 and 2011, respectively. For the three months ended September 30, 2012 and 2011, our adjusted EBITDA was $22.5 million and $20.3 million, respectively, and $52.3 million and $74.4 million for the nine months ended September 30, 2012 and 2011, respectively.

Management believes that the VAT activity that relates to periods prior to notification from the European Union tax authorities, which we refer to as VAT not charged to customers, should be excluded from adjusted non-GAAP net income (loss) and adjusted EBITDA. After our acquisition of Various, we became aware that Various and its subsidiaries had not collected VAT from subscribers in the European Union nor had Various remitted VAT to the tax jurisdictions requiring it. We have since registered with the tax authorities of the applicable European Union jurisdictions. We began collecting VAT from subscribers in July 2008, and all amounts from July 2008 and beyond are considered current VAT and such costs are presented on a net basis and excluded from revenue in the statement of operations. Since the VAT liabilities not charged to customers, including penalties, interest expense, gains and losses on settlements and foreign exchange gains and losses, is unusual and not representative of our current operations, we have excluded it from adjusted EBITDA.

Impact of JigoCity Discontinued Operations is added back to EBITDA as it relates to businesses of the Company no longer operated. In addition, acquisition related Contingent Consideration is subtracted as it is a non-cash liability.

Stock Compensation Expense was added back as it is a non-cash item that does not relate to the operating performance of the Company.

Lastly, Indenture Fee and Severance Expense were added back as those do not relate to the operating performance of the Company.

Liquidity and Capital Resources

On May 16, 2011, we completed our IPO and issued 5,000,000 shares of common stock at a price of $10.00 per share, raising proceeds of approximately $43.5 million, net of underwriting discounts and commissions and estimated offering costs. Such net proceeds were used to redeem approximately $39.5 million in principal amount of long term debt.

As of September 30, 2012, we had cash of $14.6 million, plus restricted cash of $10.0 million compared to $23.4 million and $11.2 million as of December 31, 2011. We generate our cash flows from operations. For the nine months ended September 30, 2012 and 2011, cash flows generated from operations were $10.4 million and $21.6 million, respectively. We have no working capital line of credit. Our current New First Lien Notes and Cash Pay Second Lien Notes require us to make principal payments equivalent to 85% of Excess Cash Flow, as defined at 110% of principal 35 calendar days after each quarter end (See Note 9d). During the nine months ended September 30, 2012, the principal of such notes was reduced by $16.1 million from Excess Cash Flow.

We did not make an Excess Cash Flow payment due on November 5, 2012 and therefore, the New First Lien Notes and Cash Pay Second Lien Notes are in default as of November 5, 2012, and the grace period with respect thereto lapsed on November 14, 2012. As such, post-default interest of 17.5% accrues commencing as of the default date. We have received forbearance agreements from over 80% of our senior lenders and all of our Cash Pay Second Lien lenders with respect to such defaults in exchange for a forbearance fee equal to one-half of a percent (0.5%) of the outstanding principal amount of the notes held by such lender. The forbearance agreements remain in place until the earlier of February 4, 2013, a default other than for not making the Excess Cash Flow payment, acceleration by the Trustee, or certain other circumstances. The New First Lien Notes and Cash Pay Second Lien Notes are classified as current liabilities in the accompanying balance sheet at September 30, 2012.

We also made the second payment due to the Broadstream settlement of $5.0 million on September 29, 2011, and the final payment of $2.0 million on January 3, 2012.

The total amount of uncollected payments related to VAT not charged to customers as of September 30, 2012 was $37.5 million, including $21.3 million in potential penalties and interest. We are currently negotiating with tax authorities in the applicable European Union jurisdictions to extend the maturity of the payments. We have settled with tax authorities or paid our tax liabilities in full in certain countries. We are in different stages of negotiations with many other jurisdictions, and we are not able to estimate when the rest of the jurisdictions will be settled or paid in full. However, if we were forced to pay the total amount in the next year, it would have a material adverse effect on our liquidity and capital resources since we will not have sufficient cash flow over the next year to pay these obligations and we expect that our ability to borrow funds to pay these obligations would be limited.

Due to our Excess Cash Flow prepayment default, the New First Lien Notes and Cash Pay Second Lien Notes are subject to a maturity date acceleration by the lenders; however, over 80% of the First Lien lenders and all of the Cash Pay Second Lien lenders have executed forbearance agreements with us. The New First Lien Notes and Cash Pay

Second Lien Notes mature on September 30, 2013 and are classified as current liabilities in the accompanying balance sheet at September 30, 2012. We are also in default of certain financial ratios and financial requirements under the Indentures to the Non-Cash Pay Second Lien Notes. Under the terms of the Intercreditor and Subordination Agreement among the Trustee under the Indentures for the New First Lien Notes, the Cash Pay Second Lien Notes and the Non-Cash Pay Second Lien Notes, neither the Trustee nor the holders of the Non-Cash Pay Second Lien Notes may accelerate the Notes or take any other Enforcement Action (as defined in the Indenture governing the Non-Cash Pay Second Lien Notes). The Non-Cash Pay Second Lien Notes mature on April 30, 2014. We will be required to either restructure or refinance these notes prior to their maturity dates. We are actively exploring opportunities to refinance the Notes and we have retained CRT Capital Group LLC as our financial advisor to help explore opportunities to refinance the Notes. Based on cash provided from operating activities (after interest payments on debt) during the past several years and the nine-month period, a substantial percentage of which has been needed to make principal payments on debt and forecasts of future operating cash flow, we anticipate that we will be able to either restructure or refinance the Notes; however there is no assurance that we will be able to accomplish such transactions on acceptable terms, or at all. Our inability to accomplish a successful restructuring or refinancing of the Notes will have a material adverse effect on our financial condition and may effect our ability to continue operations.

Cash Flow

Net cash provided by operations was $10.4 million for the nine months ended September 30, 2012 compared to $21.6 million for the same period in 2011. The decrease was primarily attributable to increases in operating losses and loss from discontinued operations in 2012.

Net cash used in investing activities for the nine months ended September 30, 2012 was $3.1 million compared to $6.5 million for the same period in 2011. This decrease resulted from decreased purchases of property and equipment and acquisitions.

Net cash used in financing activities for the nine months ended September 30, 2012 was $16.1 million, compared to $33.2 million for the same period in 2011. The decrease is primarily due to reductions in the amounts to repay debt.

Information Regarding EBITDA Covenants

Giving effect to the New Financing, we were required to maintain the following levels of EBITDA (as it is defined in the applicable Indenture, as amended):

- For the last four quarters for any period ending through December 30, 2011, December 30, 2012 and December 30, 2013, our EBITDA on a consolidated basis for the year ended on such date needs to be greater than $85.0 million, $90.0 million and $95.0 million, respectively. Our EBITDA for the four quarters ended December 31, 2011 was $92.9 million.

In March, 2012, we entered into Supplemental Indentures with the Trustee governing the 14% First Lien Notes due 2013 and 14% Cash Pay Second Lien Notes due 2013. The Supplemental Indentures were approved by the Required Holders and provided for modifications which were substantially the same under each such indenture. Each Supplemental Indenture provides that the Consolidated EBITDA minimum requirement (as defined in each indenture, as amended) be reset to provide that for the period of any four consecutive fiscal quarters, Consolidated EBITDA shall not be less than $65 million through December 31, 2012, not less than $75 million through March 31, 2013, and not less than $80 million through June 30, 2013. Consolidated EBITDA for the fiscal quarter ended September 30, 2012 shall not be less than $16 million and the combined Consolidated EBITDA for the third and fourth fiscal quarters of 2012 (ending September 30, 2012 and December 31, 2012, respectively) shall not be less than $36 million. In addition, starting with the fiscal quarter ending March 31, 2013, the average of any two consecutive quarters going forward shall not be less than $20 million. Our EBITDA for the four quarters ended September 30, 2012 was $71.2 million and the EBITDA for the quarter ended September 30, 2012 was $22.5 million.

The indenture governing the Non-Cash Second Lien Notes was not modified and as a result, as of the date of this filing, we did not comply with the minimum EBITDA requirement (as defined) of $90 million for the four consecutive fiscal quarters ended September 30, 2012. Our EBITDA was calculated for such period to be $71.2 million. In addition, for the third quarter of 2012, the Total Debt Ratio (as defined) of 7.1:1.0 was above the required maximum level of 6.1:1.0. Further, during such period we did not comply with other debt ratios and from time to time, we did not meet the minimum liquidity requirement of $10 million of Qualified Cash and did not meet the reporting requirement with respect thereto. Therefore, we are in default as of November 14, 2012 and the Non-Cash Pay Second Lien Notes are subject to the post-default interest rate of 15%. For more information regarding the default, see Footnote 9(d) – "Long-Term Debt." Under the terms of an Intercreditor and Subordination Agreement among the Trustees under the New First Lien Note Indenture, the Cash Pay Second Lien Note Indenture and the Non-Cash Pay Second Lien Indenture, neither the Trustee under the Non-Cash Pay Second Lien Indenture nor the holders of Non-Cash Pay Second Lien Notes may accelerate the Notes or take any other Enforcement Action (as defined in the applicable indenture, as amended) until the New First Lien Notes are paid in full. The Non-Cash Pay Second Lien

Notes are classified as a non-current liability in the accompanying consolidated balance sheet at September 30, 2012.

Financing Activities

We are currently highly leveraged and our outstanding notes are secured by substantially all of our assets. Our note agreements and Indentures contain many restrictions and covenants, including financial covenants regarding EBITDA. As disclosed above, we are in default under our principal debt instruments as of November 14, 2012. See the section entitled " — Information Regarding EBITDA Covenants" above. To the extent that our notes are not fully repaid, we will remain subject to such restrictions and covenants. Interest expense for the nine months ended September 30, 2012 totaled $64.2 million.

On October 27, 2010, we completed the New Financing. $305.0 million principal amount of New First Lien Notes due 2013 were co-issued by us and INI of which (a) $200.2 million was exchanged for $130.5 million outstanding principal amount of First Lien Notes, $49.4 million outstanding principal amount of Second Lien Notes and $14.5 million outstanding principal amount of former Senior Secured Notes, (b) $91.4 million was issued for cash proceeds of $89.6 million before payment of related fees and expenses of $5.8 million and (c) $13.4 million was used to pay commitment fees to the holders of New First Lien Notes and Second Lien Notes. Cash of $86.2 million was used to redeem $36.6 million of New First Lien Notes at 102% of principal, $30.6 million of Second Lien Notes (representing the remaining outstanding principal amounts of First and Second Lien Notes) and $18.3 million outstanding principal amount of former Senior Secured Notes. Cash was also used to pay $4.1 million of accrued interest on the exchanged and redeemed notes, a $825,000 redemption premium on certain exchanged New First Lien Notes and $435,000 in commitment fees to certain noteholders.

The remaining $13.5 million outstanding principal amount of former Senior Secured Notes were exchanged for $13.8 million principal amount of Cash Pay Second Lien Notes. Subordinated Convertible Notes and Subordinated Term Notes, with outstanding principal amounts of $180.2 million and $42.8 million, respectively, together with accrued interest of $9.5 million, were exchanged for $232.5 million of Non-Cash Pay Second Lien Notes co-issued by us and INI.

New First Lien Notes

The New First Lien Notes, in the principal amount of $305.0 million, of which approximately $112.0 million principal amount were issued to our stockholders including $7.5 million to entities controlled by certain officers and directors, were issued with an original issue discount of $6.1 million or 2.0%. The New First Lien Notes mature on September 30, 2013 and accrue interest at a rate per annum equal to 14.0%. Interest on the New First Lien Notes is payable quarterly on March 31, June 30, September 30 and December 31 of each year. Principal on the New First Lien Notes is payable quarterly to the extent of 75% of Excess Cash Flow as defined at 102% of principal, subject to pro-rata sharing with the Cash Pay Notes. The New First Lien Notes are guaranteed by our domestic subsidiaries and are collateralized by a first-priority lien on all their assets as well as a pledge of our subsidiaries stock. The guarantees are the senior secured obligations of each such subsidiary guarantor. The New First Lien Notes are redeemable prior to maturity at our option in whole but not in part, at 110% of principal, and at principal at maturity on September 30, 2013, plus accrued and unpaid interest. Pursuant to the terms of the Indentures, the net proceeds of the IPO must be used to redeem the New First Lien Notes and Cash Pay Second Lien Notes pro-rata at 110% of principal, plus accrued and unpaid interest. In addition, noteholders have the option of requiring us to repay the New First Lien Notes in full upon a Change of Control, as defined in the New First Lien Notes Indenture, at 110% of principal, plus accrued and unpaid interest. We shall also repay or offer to pay the New First Lien Notes and, in certain circumstances, the Cash Pay Second Lien Notes, with proceeds received from any debt or equity financing (including a secondary offering) and asset sales of $25 million or more at 110% of principal, plus accrued and unpaid interest, other asset sales, insurance claims, condemnation and other extraordinary cash receipts at principal, plus accrued and unpaid interest, subject to certain exceptions.

The New First Lien Notes Indenture contains covenants applicable to us and our subsidiaries, including covenants relating to limitations and requirements with respect to indebtedness, restricted payments, dividends and other payments affecting our subsidiaries, sale-leaseback transactions, consolidations and mergers, asset sales, acquisitions and provision of financial statements and reports.

In March 2012, the Company entered into Supplemental Indentures with the Trustee under the Company's 14% New First Lien Notes due 2013 and 14% Cash Pay Second Lien Notes due 2013. The Supplemental Indentures were approved by the Required Holders and provided for modifications which were substantially the same under each such indenture. Each Supplemental Indenture provides, among other things, that the Consolidated EBITDA minimum requirement (as defined in each indenture) be reset. A consent fee of 1% of the current outstanding amount of notes under each indenture, or $2.3 million, was paid on March 31, 2012. For more information, see Note 9 to the Company's Audited Financial Statements as of December 31, 2011 and 2010 and the years ended December 31, 2011, 2010 and 2009.

The Company did not make an Excess Cash Flow payment due in November, 2012 and therefore, the New First Lien Notes and Cash Pay Second Lien Notes are in default as of November 5, 2012, and the grace period with respect thereto lapsed on November 14, 2012. As such, post-default interest of 17.5% accrues commencing as of the default date. The Company has received forbearance agreements from over 80% of its senior lenders and all of its Cash Pay Second Lien lenders with respect to such defaults in exchange for a forbearance fee equal to one-half of a percent (0.5%) of the outstanding principal amount of the notes held by such lender. The forbearance agreement remains in place until the earlier of February 4, 2013, a default other than for not making the Excess Cash Flow payment, acceleration by the Trustee, or certain other circumstances. The New First Lien Notes and Cash Pay Second Lien Notes are classified as current liabilities in the accompanying balance sheet at September 30, 2012.

The New First Lien Notes and Cash Pay Second Lien Notes are subject to a maturity date acceleration by the lenders; however, over 80% of the New First Lien lenders and all of the Cash Pay Second Lien lenders have entered into forbearance agreements with the Company. The New First Lien Notes and Cash Pay Second Lien Notes mature on September 30, 2013 and the Non-Cash Pay Second Lien Notes mature on April 30, 2014. The Company will be required to either restructure or refinance these notes prior to their maturity dates. The Company anticipates that it will be able to either restructure or refinance the notes; however there is no assurance that the Company will be able to accomplish such transactions on acceptable terms, or at all. The Company's inability to accomplish a successful restructuring or refinancing of the notes will have a material adverse effect on the Company's financial condition.

Cash Pay Second Lien Notes

The Cash Pay Second Lien Notes, in the principal amount of $13.8 million, all of which were issued to entities controlled by stockholders who are also officers and directors, were issued with an original issue discount of $276,000 or 2%, are identical to the terms of the New First Lien Notes except as to matters regarding collateral, subordination, enforcement and voting. Cash Pay Second Lien Notes are secured by a fully subordinated second lien on substantially all of our assets, pari passu with the Non-Cash Pay Second Lien Notes, and will be included with the New First Lien Notes on a dollar for dollar basis for purposes of determining required consents or waivers on all matters except for matters relating to collateral, liens and enforcement of rights and remedies. As to such matters, the Cash Pay Second Lien Notes will be included with the Non-Cash Pay Second Lien Notes for purposes of determining required consents or waivers.

Non-Cash Pay Second Lien Notes

The Non-Cash Pay Second Lien Notes, in the principal amount of $232.5 million, of which approximately $228.5 million principal amount were issued to our stockholders including $44.4 million to entities controlled by certain officers and directors, mature on April 30, 2014 and bear interest at 11.5%, payable semi-annually on June 30 and December 31, which may be paid in additional Non-Cash Pay Second Lien Notes at our option. While the New First Lien Notes are in place, interest must be paid with additional Non-Cash Pay Second Lien Notes. The Non-Cash Pay Second Lien Notes are guaranteed by our domestic subsidiaries and collateralized by a second priority lien on all of their assets and a pledge of our subsidiaries stock; however, such security interest is subordinate to the prior payment of the New First Lien Notes. The guarantees are the senior secured obligations of each such subsidiary guarantor subordinate only to the first-priority lien granted to the holders of the New First Lien Notes. The Non-Cash Pay Second Lien Notes are redeemable, at our option, in whole but not in part, at 100% of principal, plus accrued and unpaid interest, subject to the rights of the holders of the New First Lien Notes under the intercreditor agreement between the holders of the New First Lien Notes, the holders of the Cash Pay Second Lien Notes and the holders of the Non-Cash Pay Second Lien Notes. This agreement provides that no redemption of the Non-Cash Pay Second Lien Notes may occur until the New First Lien Notes are repaid in full.

Upon the payment in full of the New First Lien Notes, principal on the Non-Cash Pay Second Lien Notes is payable quarterly to the extent of 75% of Excess Cash Flow as defined at 102% of principal subject to pro-rata sharing with the Cash Pay Second Lien Notes. Due to our IPO, if the New First Lien Notes are paid in full, the remaining proceeds must be used to redeem the Non-Cash Pay Second Lien Notes and the Cash Pay Second Lien Notes on a pro-rata basis at 110% of principal, plus accrued and unpaid interest. In addition, noteholders have the option of requiring us to repay the Non-Cash Pay Second Lien Notes in full upon a Change of Control, as defined in the Non-Cash Pay Second Lien Notes Indenture, at 110% of principal, plus accrued and unpaid interest. If the New First Lien Notes are paid in full, we shall repay the remaining Non-Cash Pay Second Lien Notes and the Cash Pay Second Lien Notes on a pro-rata basis with proceeds received from any debt or equity financing (including a secondary offering), and asset sales of over $25 million at 110% of principal, plus accrued and unpaid interest, and other asset sales, insurance claim, condemnation and other extraordinary cash receipts at principal, subject to certain exceptions.

Upon consummation of our IPO on May 16, 2011, the Non-Cash Pay Second Lien Notes became convertible into shares of our common stock. The conversion price of the Non-Cash Pay Second Lien Notes is the per share offering price for shares of our common stock upon consummation of our IPO, or $10.00 per share, provided that such conversion option shall be limited to approximately 21.1% of the fully diluted equity. The $183.7 million principal amount of Non-Cash Pay Second Lien Notes exchanged for outstanding Subordinated Convertible Notes were recorded at the carrying amount for such convertible notes as the exchange was accounted for as if the outstanding convertible notes were not extinguished. The $48.8 million principal amount of Non-Cash Pay Second Lien Notes exchanged for non-convertible Subordinated Term Notes have been recorded at estimated fair value at the date of issuance as the exchange was accounted for as an extinguishment of the Subordinated Term Notes.

The Non-Cash Pay Second Lien Notes Indenture contains covenants applicable to us and our subsidiaries, including covenants relating to limitations and requirements with respect to indebtedness, restricted payments, dividends and other payments affecting our subsidiaries, sale-leaseback transactions, consolidations and mergers, asset sales and acquisitions and provision of financial statements and reports. These covenants are substantially identical to those contained in the New First Lien Notes.

The indenture governing the Non-Cash Second Lien Notes was not modified and as a result, the Company did not comply with the minimum EBITDA requirement (as defined) of $90 million for the four consecutive fiscal quarters ended March 31, 2012, June 30, 2012 and September 30, 2012. The Company's EBITDA was calculated for such periods to be $78.2 million, $69.0 million and $71.2 million, respectively. In addition, the Total Debt Ratio (as defined) for such periods of 6.3:1.0, 7.4:1.0 and 7.1:1.0 was above the required maximum level of 6.1:1.0. Further, during the quarters ended June 30, 2012 and September 30, 2012, the Company violated certain other debt ratios. In addition, from time to time, the Company did not meet the minimum liquidity requirement of $10 million of Qualified Cash and did not meet the reporting requirement with respect thereto. Under the terms of an Intercreditor and Subordination Agreement among the Trustees under the New First Lien Note Indenture, the Cash Pay Second Lien Note Indenture and the Non-Cash Pay Second Lien Indenture, neither the Trustee under the Non-Cash Pay Second Lien Indenture nor the holders of Non-Cash Pay Second Lien Notes may accelerate the Notes or take any other Enforcement Action (as defined) until the New First Lien Notes are paid in full.

On May 11, 2012, the Trustee of the Non-Cash Pay Second Lien Notes and the Required Holders thereof waived the EBITDA covenant violation and the Total Debt Ratio for the quarter ended March 31, 2012 and minimum liquidity requirement covenant violations through August 14, 2012, as well as the failure to timely comply with minimum liquidity requirement and the reporting requirement thereof. On August 10, 2012, the Company received a waiver from the Trustee and Required Holders related to its failure to meet the minimum EBITDA requirement as well as the Total Debt and other ratios for the quarter ended June 30, 2012 and the minimum liquidity requirement waiver was extended through November 14, 2012. However, the waiver was not extended beyond November 14, 2012. Therefore, the Company is in default as of November 14, 2012 and the Non-Cash Pay Second Lien Notes are subject to the post-default interest rate of 15%. The Non-Cash Pay Second Lien Notes are classified as non-current liabilities in the accompanying balance sheet as of September 30, 2012.

On May 16, 2011, we completed our IPO and issued 5,000,000 shares of common stock at a price of $10.00 per share, raising proceeds of approximately $43.5 million, net of underwriting discounts and commissions and estimated offering costs. Such net proceeds were used to redeem approximately $39.5 million in principal amount of long term debt.

Registration Rights

We agreed to consummate an exchange offer pursuant to an effective registration statement to be filed with the SEC to allow the holders of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes to exchange their notes for a new issue of substantially identical notes. On August 1, 2011, we filed a registration statement with the SEC relating to the exchange offer. In addition, we agreed to file under certain circumstances, a shelf registration statement to cover resales of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes. In October 2011, due to an interpretation of the SEC which did not allow an exchange offer for the above referenced notes, we withdrew the exchange offer. On October 18, 2011, we filed a registration statement on Form S-1 to cover re-sales of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes. In the event that we fail to satisfy the registration and/or exchange requirements within prescribed time periods, the interest rate on the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes will be increased by 3.5 percentage points. (See Note 9 — "Long Term Debt"). The SEC declared the registration statement on Form S-1 to cover re-sales of the New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes effective on December 19, 2011.

Contractual Obligations

The following table sets forth our contractual obligations as of September 30, 2012:

	Payments due by period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	($ in thousands)				
Long-term Notes Payable, including current portion:					
New First Lien Notes(1)	$ 212,988	$ 212,988	$ —	$ —	$ —
Cash Pay Second Lien Notes(1)	9,622	9,622	—	—	—
Non-Cash Pay Second Lien Notes(1)	280,526		280,526	—	—
Sellers Agreements(2)	1,250	1,250	—	—	—
Operating Leases(3)	9,278	2,604	5,555	707	412
Other (4)	1,509	1,506	3	—	—

Total (5)	$ 515,173	$ 227,970	$ 286,084	$ 707	$ 412

(1) We used the net cash proceeds from our initial public offering of our common stock to repay a portion of the New First Lien Notes and Cash Pay Second Lien Notes pro rata at a redemption price of 110%, plus accrued and unpaid interest. The New First Lien Notes and Cash Pay Second Lien Notes mature on September 30, 2013. The Non-Cash Pay Second Lien Notes mature on April 30, 2014.

(2) Agreements with the former owners of Various was originally recorded in 2010 at a present value of $2.3 million using discount rate of 15%.

(3) Represents our minimum rental commitments for non-cancellable operating leases of office space.

(4) Other commitments and obligations are comprised of contracts with software licensing, communications, computer hosting, and marketing service providers. These amounts totaled $1.5 million for less than one year. Contracts with other service providers are for 30 day terms or less.

(5) Interest expense has been excluded from the Contractual Obligations table above. As of September 30, 2012, the Company had $213.0 million and $9.6 million of New First Lien Notes and Cash Pay Second Lien Notes, respectively, which would result in an annual cash interest expense obligation of $31.3 million before giving effect to required principal reductions from excess cash flow. No cash interest payments are payable in respect of Non-Cash Pay Second Lien Notes.

Off-Balance Sheet Transactions

As of September 30, 2012, we did not have any off-balance sheet arrangements.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk attributed to interest and foreign currency exchange rates.

Interest Rate Fluctuation Risk

We are not exposed to any interest rate fluctuations.

Foreign Currency Exchange Risk

Our exposure to foreign currency exchange risk is due to our international operations. As of September 30, 2012, we had a $40.0 million liability for VAT denominated in Euros and $1.2 million of restricted cash denominated in Euros and Pounds held by foreign credit card processors, which represent substantially all of our foreign currency exchange rate exposure. In addition, we have foreign currency exposure related to the net assets and operations of JigoCity which we acquired in September 2011 however, such exposure has been ended with the discontinuance of such operations. In addition, revenues derived from international websites are paid in advance primarily with credit cards and are denominated in local currencies. Substantially all such currencies are converted into U.S. dollars on the dates of the transactions at rates of exchange in effect on such dates and remitted to us and accordingly, is recorded based on the U.S. dollars received by us. As a result, our foreign currency exchange risk exposure is not material and is limited to the amount of foreign exchange rate changes on any individual day on the portion of our net revenue received in other currencies. Restricted cash held by foreign credit card processors and VAT liabilities denominated in foreign currencies are converted into U.S. dollars using current exchange rates in effect as of the balance sheet date. Gains and losses resulting from transactions denominated in foreign currencies are recorded in the statement of operations. The potential loss resulting from a hypothetical 10.0% adverse change in quoted foreign currency exchange rates is approximately $4.0 million. We do not utilize any currency hedging strategies.

Operations of JigoCity's foreign subsidiaries are conducted in local currencies which represents their functional currencies. Balance sheet accounts of such subsidiaries are translated from foreign currencies into U.S. dollars at the exchange rate in effect at each balance sheet date and income statement accounts are translated at the average rate of exchange prevailing during the period. Translation adjustments resulting from this process, which were not significant at September 30, 2012, are not included in the statement of operations, but are included in accumulated other comprehensive income on the consolidated balance sheet.

Inflation Risk

We are subject to the effects of changing prices. We have, however, generally been able to pass along inflationary increases in our costs by increasing the prices of our products and subscriptions.

ITEM 4: CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules

13a-15(e) and 15d-15(e) of the Exchange Act) as of September 30, 2012. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of September 30, 2012 to provide reasonable assurance that information required to be disclosed by us in reports we file or submit under the Exchange Act is (1) recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (2) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Change In Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have determined that, during the fiscal quarter ended September 30, 2012, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or 15d-15 under the Exchange Act, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board issued new authoritative accounting guidance which will allow entities to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company adopted this guidance effective January 1, 2012 without impact to its financial statements.

In June 2011, the FASB issued authoritative guidance that amends the presentation of comprehensive income in the financial statements by requiring an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The update also eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance is effective for interim and annual reporting periods beginning on or after December 15, 2011, with early adoption permitted. The Company adopted this guidance effective January 1, 2012.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

There are no material changes to the material pending legal proceedings described in our Form 10-K for the year ended December 31, 2011, which was filed with the Securities and Exchange Commission on March 29, 2012.

Item 1A. RISK FACTORS

Item 1A of Part 1 of our Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission on March 29, 2012 includes a detailed discussion of the risk factors that could materially affect our business, financial conditions or future prospects. Set forth below is a discussion of the material changes in our risk factors previously disclosed in our Form 10-K. The information below updates, and should be read in conjunction with, the risk factors in our Form 10-K. We encourage you to read these risk factors in their entirety.

We are currently in default under our New First Lien Notes, Cash Pay Second Lien Notes and Non-Cash Pay Second Lien Notes. Although we are operating under forebearance agreements with over 80% of the noteholders of the New First Lien Notes and 100% of the Cash Pay Second Lien Notes, if we do not reestablish compliance with certain financial covenants, ratios and tests by the earlier of February 2013 or the occurrence of certain other circumstances, and otherwise remain in compliance with the Indentures governing our Notes, the holders of the New First Lien Notes and Cash Pay Second Lien Notes could accelerate this indebtedness and we may be unable to pay the total amount of indebtedness due or we may be unable to find alternative sources of financing to refinance our indebtedness on acceptable terms or at all.

The indentures governing our Notes contain certain financial covenants and restrictions requiring us to maintain specified financial ratios and satisfy certain financial tests. As a result of these covenants and restrictions, we are limited in how we conduct our business and we may be unable to raise additional debt or equity financing, compete effectively or take advantage of new business opportunities.

We did not make an Excess Cash Flow payment due on November 5, 2012 and as a result the New First Lien Notes and Cash Pay Second Lien Notes are in default and the applicable grace period expired on November 14, 2012. Post-default interest of 17.5% accrues commencing as of the default date. We have received forbearance agreements from over 80% of the New First Lien Notes and 100% of the Cash Pay Second Lien Notes with respect to such defaults in exchange for a forbearance fee equal to one-half of a percent (0.5%) of the outstanding principal amount of the Notes held by such lenders. The forbearance agreement remains in place until the earlier of February 4, 2013, the occurrence of a default other than for not making the Excess Cash Flow payment, acceleration by the Trustee, or certain other circumstances.

Additionally, as of the date of this filing, we did not comply with the minimum EBITDA requirement (as defined in the applicable indenture, as amended) of the Non-Cash Pay Second Lien Notes of $90 million for the four consecutive fiscal quarters ended September 30, 2012. Our EBITDA was calculated for such period to be $71.2 million. In addition, the Total Debt Ratio (as defined in the applicable indenture, as amended) of 7.1:1.0 was above the required maximum level of 6.1:1.0. Further, we did not comply with other debt ratios during such period and from time to time, we did not meet the minimum liquidity requirement of $10 million of Qualified Cash and did not meet the reporting requirement with respect thereto. Therefore, we are in default as of November 14, 2012 and the Non-Cash Pay Second Lien Notes are subject to the post-default interest rate of 15%. Under the terms of an Intercreditor and

Subordination Agreement among the Trustee under the New First Lien Note Indenture, the Cash Pay Second Lien Note Indenture and the Non-Cash Pay Second Lien Indenture, neither the Trustee under the Non-Cash Pay Second Lien Indenture nor the holders of Non-Cash Pay Second Lien Notes may accelerate the Non-Cash Pay Second Lien Notes or take any other Enforcement Action (as defined in the applicable indenture, as amended) until the New First Lien Notes are paid in full.

If the forbearance period under the forbearance agreements lapses prior to February 4, 2013, further events of default occur in the future under any of the indentures governing our Notes and our efforts to cure such events of default are unsuccessful, it would likely result in the acceleration of our then-outstanding debt, which in turn could trigger the cross-default and cross-acceleration provisions of our other financing agreements. If all of our indebtedness was accelerated as a result of an event of default, we may not have sufficient funds at the time of acceleration to repay in full the total amount of indebtedness that becomes due as a result of such acceleration and we may be unable to find alternative sources of financing to refinance our indebtedness on terms that are acceptable to us or at all.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

The Company did not make a required Excess Cash Flow payment due in November, 2012 on the New First Lien Notes and Cash Pay Second Lien Notes and therefore, such Notes are in default as of November 14, 2012. As such, post-default interest of 17.5% accrues commencing as of the default date. The New First Lien Notes and Cash Pay Second Lien Notes are classified as current liabilities in the accompanying balance sheet at September 30, 2012.

The New First Lien Notes and Cash Pay Second Lien Notes are subject to a maturity date acceleration by the lenders; however, over 80% of the New First Lien lenders and all of the Cash Pay Second Lien lenders have entered into forbearance agreements with the Company in exchange for a forbearance fee equal to one-half of a percent (0.5%) of the outstanding principal amount of the notes held by such lender. The forbearance agreement remains in place until the earlier of February 4, 2013, a default other than for not making the Excess Cash Flow payment, acceleration by the Trustee, or certain other circumstances. The New First Lien Notes and Cash Pay Second Lien Notes mature on September 30, 2013 and the Non-Cash Pay Second Lien Notes mature on April 30, 2014. The Company will be required to either restructure or refinance these notes prior to their maturity dates. The Company anticipates that it will be able to either restructure or refinance the notes; however there is no assurance that the Company will be able to accomplish such transactions on acceptable terms, or at all. The Company’s inability to accomplish a successful restructuring or refinancing of the notes will have a material adverse effect on the Company’s financial condition.

Item 4. MINE SAFETY DISCLOSURES

Not Applicable.

Item 5. OTHER INFORMATION

Non-Cash Pay Second Lien Notes

As of the date of this filing, the Company did not comply with the minimum EBITDA requirement (as defined in the indenture, as amended) of the Non-Cash Pay Second Lien Notes of $90 million for the four consecutive fiscal quarters ended September 30, 2012. The Company’s EBITDA was calculated for such period to be $71.2 million. In addition, the Total Debt Ratio (as defined in the indenture, as amended) of 7.1:1.0 was above the required maximum level of 6.1:1.0. Further, the Company during such period did not comply with other debt ratios and from time to time, the Company did not meet the minimum liquidity requirement of $10 million of Qualified Cash and did not meet the reporting requirement with respect thereto. Therefore, the Company is in default as of November 14, 2012 and the Non-Cash Pay Second Lien Notes are subject to the post-default interest rate of 15%. For more information regarding the default, see Footnote 9(d) – "Long-Term Debt." Under the terms of an Intercreditor and Subordination Agreement among the Trustees under the New First Lien Note Indenture, the Cash Pay Second Lien Note Indenture and the Non-Cash Pay Second Lien Indenture, neither the Trustee under the Non-Cash Pay Second Lien Indenture nor the holders of Non-Cash Pay Second Lien Notes may accelerate the Notes or take any other Enforcement Action (as defined in the Indenture, as amended) until the New First Lien Notes are paid in full. The Non-Cash Pay Second Lien Notes are classified as a non-current liability in the accompanying consolidated balance sheet at September 30, 2012.

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Item 6. EXHIBITS

Exhibit No.	Description of Exhibit
4.77	Form of Forbearance Agreement, dated as of November 5, 2012, by and among Interactive Network, Inc., FriendFinder Networks Inc. and certain holders of the First Lien Notes (1)
4.78	Form of Forbearance Agreement, dated as of November 5, 2012, by and among FriendFinder Networks Inc., Interactive Network, Inc. and the holders of the Cash Pay Secured Notes (1)
10.1	Consulting Agreement, dated as of October 5, 2012 between FriendFinder Networks Inc. and Marc H. Bell (2)
10.2	Consulting Agreement, dated as of October 5, 2012 between FriendFinder Networks Inc. and Daniel C. Staton (2)
10.3	Agreement in Continuation of Certain Equity Awards, dated as of October 5, 2012 between FriendFinder Networks Inc. and Marc H. Bell (2)
10.4	Agreement in Continuation of Certain Equity Awards, dated as of October 5, 2012 between FriendFinder Networks Inc. and Daniel C. Staton (2)
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.INS	XBRL Instance Document #*
101.SCH	XBRL Taxonomy Extension Schema Document#*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document#*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document#*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document#*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document#*

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, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under those sections.

* Filed herewith.

(1) Incorporated by reference to the corresponding exhibits to the Form 8-K filed on November 8, 2012.

(2) Incorporated by reference to the corresponding exhibit to the Form 8-K filed on October 5, 2012.

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

	By: /s/ Anthony Previte
Date: November 14, 2012	Name: Anthony Previte Chief Executive Officer (Duly Authorized Officer and Principal Executive Officer)
	By: /s/Ezra Shashoua Name: Ezra Shashoua Chief Financial Officer (Principal Financial and Accounting Officer)

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