

Edgar Filing: Professional Diversity Network, Inc. - Form 10-Q

Professional Diversity Network, Inc.  
Form 10-Q  
August 14, 2014

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

FORM 10-Q

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2014

OR

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_ .

Commission File Number: 001-35824

Professional Diversity Network, Inc.  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or other jurisdiction of incorporation or  
organization)

80-0900177  
(I.R.S. Employer Identification No.)

801 W. Adams Street, Suite 600, Chicago, Illinois 60607  
(address of principal executive offices) (Zip Code)

Telephone: (312) 614-0950  
(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

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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.

Large accelerated filer ☐  
Non-accelerated filer ☐

Accelerated filer ☐  
Smaller reporting company ☒

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

There were 6,309,845 shares outstanding of the registrant's common stock as of August 14, 2014.

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PROFESSIONAL DIVERSITY NETWORK, INC.

FORM 10-Q  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

Professional Diversity Network, Inc.

CONDENSED BALANCE SHEETS (Unaudited)

|                                                                                                                                                                                                                                                 | June 30,<br>2014 | December 31,<br>2013 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|----------------------|
| Current Assets:                                                                                                                                                                                                                                 |                  |                      |
| Cash and cash equivalents                                                                                                                                                                                                                       | \$5,609,138      | \$ 18,736,495        |
| Accounts receivable                                                                                                                                                                                                                             | 1,542,643        | 1,218,112            |
| Short-term investments                                                                                                                                                                                                                          | 11,876,078       | -                    |
| Prepaid expenses and other current assets                                                                                                                                                                                                       | 331,882          | 99,094               |
| Total current assets                                                                                                                                                                                                                            | 19,359,741       | 20,053,701           |
| Property and equipment, net                                                                                                                                                                                                                     | 55,957           | 54,781               |
| Security deposits                                                                                                                                                                                                                               | 12,644           | 12,644               |
| Prepaid license fee                                                                                                                                                                                                                             | 450,000          | -                    |
| Capitalized technology, net                                                                                                                                                                                                                     | 616,296          | 692,511              |
| Goodwill                                                                                                                                                                                                                                        | 735,328          | 735,328              |
| Trade name                                                                                                                                                                                                                                      | 90,400           | 90,400               |
| Deferred tax asset                                                                                                                                                                                                                              | 893,421          | 380,832              |
| Total assets                                                                                                                                                                                                                                    | \$22,213,787     | \$ 22,020,197        |
| Current Liabilities:                                                                                                                                                                                                                            |                  |                      |
| Accounts payable                                                                                                                                                                                                                                | \$306,581        | \$ 222,961           |
| Accrued expenses                                                                                                                                                                                                                                | 710,239          | 188,462              |
| Deferred revenue                                                                                                                                                                                                                                | 1,377,015        | 1,024,420            |
| Warrant liability                                                                                                                                                                                                                               | 71,689           | 85,221               |
| Total current liabilities                                                                                                                                                                                                                       | 2,465,524        | 1,521,064            |
| Commitments and contingencies                                                                                                                                                                                                                   |                  |                      |
| Stockholders' Equity                                                                                                                                                                                                                            |                  |                      |
| Common stock, \$0.01 par value, 25,000,000 shares authorized,<br>6,318,227 shares issued as of June 30, 2014 and December 31, 2013<br>and 6,309,845 and 6,316,027 shares outstanding as of June 30, 2014<br>and December 31, 2013, respectively | 63,182           | 63,182               |
| Additional paid in capital                                                                                                                                                                                                                      | 21,909,289       | 21,883,593           |
| Accumulated deficit                                                                                                                                                                                                                             | (2,187,091 )     | (1,436,387 )         |
| Treasury stock, at cost; 8,382 shares at June 30, 2014 and 2,200<br>shares at December 31, 2013                                                                                                                                                 | (37,117 )        | (11,255 )            |
| Total stockholders' equity                                                                                                                                                                                                                      | 19,748,263       | 20,499,133           |
| Total liabilities and stockholders' equity                                                                                                                                                                                                      | \$22,213,787     | \$ 22,020,197        |

The accompanying notes are an integral part of these unaudited financial statements.



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Professional Diversity Network, Inc.

CONDENSED STATEMENTS OF COMPREHENSIVE LOSS (Unaudited)

|                                                                                                            | Three Months Ended June 30, |               | Six Months Ended June 30, |               |
|------------------------------------------------------------------------------------------------------------|-----------------------------|---------------|---------------------------|---------------|
|                                                                                                            | 2014                        | 2013          | 2014                      | 2013          |
| Revenues                                                                                                   |                             |               |                           |               |
| Recruitment services                                                                                       | \$ 585,106                  | \$ 556,111    | \$ 1,401,450              | \$ 1,091,791  |
| Consumer advertising and consumer marketing solutions revenue                                              | 447,181                     | 420,809       | 868,491                   | 804,932       |
| Total revenues                                                                                             | 1,032,287                   | 976,920       | 2,269,941                 | 1,896,723     |
| Costs and expenses:                                                                                        |                             |               |                           |               |
| Cost of services                                                                                           | 395,754                     | 247,005       | 762,225                   | 486,218       |
| Sales and marketing                                                                                        | 763,083                     | 576,018       | 1,559,527                 | 1,031,827     |
| General and administrative                                                                                 | 572,018                     | 527,048       | 1,107,715                 | 948,114       |
| Depreciation and amortization                                                                              | 93,648                      | 60,563        | 184,555                   | 115,987       |
| Gain on sale of property and equipment                                                                     | -                           | -             | -                         | (4,734 )      |
| Total costs and expenses                                                                                   | 1,824,503                   | 1,410,634     | 3,614,022                 | 2,577,412     |
| Loss from operations                                                                                       | (792,216 )                  | (433,714 )    | (1,344,081 )              | (680,689 )    |
| Other income (expense)                                                                                     |                             |               |                           |               |
| Interest expense                                                                                           | -                           | -             | -                         | (155,137 )    |
| Interest and other income                                                                                  | 1,010                       | 9,132         | 67,256                    | 14,357        |
| Other income (expense), net                                                                                | 1,010                       | 9,132         | 67,256                    | (140,780 )    |
| Change in fair value of warrant liability                                                                  | (30,277 )                   | 200,495       | 13,532                    | 311,303       |
| Loss before income taxes                                                                                   | (821,483 )                  | (224,087 )    | (1,263,293 )              | (510,166 )    |
| Income tax (benefit) expense                                                                               | (333,322 )                  | (90,925 )     | (512,589 )                | 104,812       |
| Net loss                                                                                                   | \$ (488,161 )               | \$ (133,162 ) | \$ (750,704 )             | \$ (614,978 ) |
| Other comprehensive (loss) income:                                                                         |                             |               |                           |               |
| Net loss                                                                                                   | \$ (488,161 )               | \$ (133,162 ) | \$ (750,704 )             | \$ (614,978 ) |
| Unrealized gains on marketable securities                                                                  | -                           | (8,799 )      | -                         | (5,361 )      |
| Comprehensive loss                                                                                         | \$ (488,161 )               | \$ (141,961 ) | \$ (750,704 )             | \$ (620,339 ) |
| Net loss per common share, basic and diluted                                                               | \$ (0.08 )                  | \$ (0.02 )    | \$ (0.12 )                | \$ (0.12 )    |
| Shares used in computing pro forma net loss per common share:                                              |                             |               |                           |               |
| Basic and diluted                                                                                          | 6,313,717                   | 6,318,227     | 6,314,866                 | 5,318,564     |
| Pro-forma computation related to conversion to a C corporation upon completion of initial public offering: |                             |               |                           |               |
| Historical pre-tax net loss before taxes                                                                   | \$ (821,483 )               | \$ (224,087 ) | \$ (1,263,293 )           | \$ (510,166 ) |
| Pro-forma tax benefit                                                                                      | (333,322 )                  | (90,925 )     | (512,589 )                | (225,295 )    |
| Pro-forma net loss                                                                                         | \$ (488,161 )               | \$ (133,162 ) | \$ (750,704 )             | \$ (284,871 ) |
| Pro-forma loss per share - basic and diluted                                                               |                             |               |                           |               |

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|                                               |            |            |            |            |
|-----------------------------------------------|------------|------------|------------|------------|
| Unaudited pro-forma loss per share            | \$ (0.08 ) | \$ (0.02 ) | \$ (0.12 ) | \$ (0.05 ) |
| Weighted average number of shares outstanding | 6,313,717  | 6,318,227  | 6,314,866  | 5,318,564  |

The accompanying notes are an integral part of these unaudited financial statements.

Professional Diversity Network, Inc.

CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)

|                              | Common<br>Shares | Stock<br>Amount | Additional<br>Paid In<br>Capital | Accumulated<br>Deficit | Treasury Stock<br>Shares | Treasury Stock<br>Amount | Total<br>Stockholders'<br>Equity |
|------------------------------|------------------|-----------------|----------------------------------|------------------------|--------------------------|--------------------------|----------------------------------|
| Balance at December 31, 2013 | 6,318,227        | \$63,182        | \$21,883,593                     | \$(1,436,387)          | 2,200                    | \$(11,255)               | \$20,499,133                     |
| Repurchase of common stock   | -                | -               | -                                | -                      | 6,182                    | (25,862)                 | (25,862 )                        |
| Stock-based compensation     | -                | -               | 25,696                           | -                      | -                        | -                        | 25,696                           |
| Net loss                     | -                | -               | -                                | (750,704 )             | -                        | -                        | (750,704 )                       |
| Balance at June 30, 2014     | 6,318,227        | \$63,182        | \$21,909,289                     | \$(2,187,091)          | 8,382                    | \$(37,117)               | \$19,748,263                     |

The accompanying notes are an integral part of these unaudited financial statements.

Professional Diversity Network, Inc.  
CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

|                                                                                           | Six Months Ended June 30, |              |
|-------------------------------------------------------------------------------------------|---------------------------|--------------|
|                                                                                           | 2014                      | 2013         |
| Cash flows from operating activities:                                                     |                           |              |
| Net loss                                                                                  | \$(750,704 )              | \$(614,978 ) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: |                           |              |
| Depreciation and amortization                                                             | 184,554                   | 115,987      |
| Deferred tax (benefit) expense                                                            | (512,589 )                | 104,812      |
| Stock-based compensation expense                                                          | 25,696                    | -            |
| Change in fair value of warrant liability                                                 | (13,532 )                 | (311,303 )   |
| Gain on sale of property and equipment                                                    | -                         | (4,734 )     |
| Interest added to notes payable                                                           | -                         | 16,881       |
| Accretion of interest on notes payable                                                    | -                         | 138,255      |
| Changes in operating assets and liabilities:                                              |                           |              |
| Accounts receivable                                                                       | 125,469                   | 1,541,798    |
| Accounts payable                                                                          | 83,620                    | (40,850 )    |
| Accrued expenses                                                                          | 71,777                    | 31,386       |
| Prepaid expenses and other current assets                                                 | (232,788 )                | (109,828 )   |
| Deferred income                                                                           | (97,405 )                 | -            |
| Net cash (used in) provided by operating activities                                       | (1,115,902 )              | 867,426      |
| Cash flows from investing activities:                                                     |                           |              |
| Proceeds from maturities of short-term investments                                        | 3,100,000                 | -            |
| Purchases of short-term investments                                                       | (14,976,078 )             | -            |
| Cash paid to purchase technology                                                          | -                         | (200,000 )   |
| Costs incurred to develop technology                                                      | (97,918 )                 | (164,875 )   |
| Sale of property and equipment                                                            | -                         | 6,203        |
| Purchases of property and equipment                                                       | (11,597 )                 | (32,564 )    |
| Net cash used in investing activities                                                     | (11,985,593 )             | (391,236 )   |
| Cash flows from financing activities:                                                     |                           |              |
| Distributions to members                                                                  | -                         | (200,000 )   |
| Proceeds from IPO, net of offering costs                                                  | -                         | 19,474,565   |
| Deferred IPO costs                                                                        | -                         | (479,356 )   |
| Repurchase of common stock                                                                | (25,862 )                 | -            |
| Net cash (used in) provided by financing activities                                       | (25,862 )                 | 18,795,209   |
| Net (decrease) increase in cash and cash equivalents                                      | (13,127,357 )             | 19,271,399   |
| Cash and cash equivalents, beginning of period                                            | 18,736,495                | 868,294      |
| Cash and cash equivalents, end of period                                                  | \$5,609,138               | \$20,139,693 |
| Supplemental disclosures of other cash flow information:                                  |                           |              |
| Cash paid for income taxes                                                                | \$-                       | \$-          |
| Cash paid for interest                                                                    | \$-                       | \$-          |
| Non-cash disclosures:                                                                     |                           |              |
| Accrued expenses related to license fee                                                   | \$450,000                 | \$-          |

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|                                                                |     |             |
|----------------------------------------------------------------|-----|-------------|
| IPO costs in accounts payable                                  | \$- | \$30,567    |
| Deferred revenue in accounts receivable                        | \$- | \$65,836    |
| Conversion of notes payable to equity                          | \$- | \$1,643,036 |
| Reduction of additional paid-in capital for deferred IPO costs | \$- | \$1,342,163 |

The accompanying notes are an integral part of these unaudited financial statements.

Professional Diversity Network, Inc.  
Condensed Notes to Financial Statements

1. Description of Business

Professional Diversity Network, Inc. (the “Company,” “Professional Diversity Network,” “we,” “our” and “us”) is a corporation organized under the laws of Delaware, originally formed as IH Acquisition, LLC under the laws of the State of Illinois on October 3, 2003. The Company operates online professional networking communities with career resources specifically tailored to the needs of different diverse cultural groups including: Women, Hispanic-Americans, African-Americans, Asian-Americans, Disabled, Military Professionals, Lesbians, Gay, Bisexual and Transgender (LGBT), and Students and Graduates seeking to transition from education to career. The networks’ purposes, among others, are to assist its members in their efforts to connect with like-minded individuals, identify career opportunities within the network and connect members with prospective employers. The Company’s technology platform is integral to the operation of its business.

2. Liquidity, Financial Condition and Management’s Plans

The Company funds its operations principally from cash on hand and accounts receivable collected.

The Company completed an initial public offering (“IPO”) of its equity securities on March 8, 2013 and received \$19,474,565 in proceeds, net of offering costs.

As more fully described in Note 9 below, we entered into a diversity recruitment partnership agreement with LinkedIn Corporation (“LinkedIn”) on November 12, 2012, which became effective on January 1, 2013 and terminated on March 29, 2014. Under our business agreement with LinkedIn, LinkedIn made fixed quarterly payments to us in the amount of \$500,000 per quarter and paid us commissions for sales of our services in excess of certain thresholds. The agreement with LinkedIn terminated on March 29, 2014 and, as a result, LinkedIn is no longer a reseller of the Company’s products or services and the Company will not receive the fixed quarterly payments of \$500,000 or have the potential to earn additional commission revenue from LinkedIn. The termination of our agreement with LinkedIn will have a material impact on revenue and operating cash flow in the near term. However, as of March 30, 2014, we are permitted to market and sell our products to any company, including those 1,000 companies on LinkedIn’s restricted account list because as part of our termination arrangement with LinkedIn, the restricted account list will no longer apply. The Company has implemented a plan to actively engage with the 1,000 companies that were formerly restricted from us by the agreement with LinkedIn. In addition, we are also marketing to customers that had purchased our products through contracts with LinkedIn with the intent of renewing those contracts directly as they expire over the coming 12 months. We feel that our existing salesforce has the capacity to service the additional potential customers we are targeting as a result of the termination of the LinkedIn agreement.

The termination of our agreement with LinkedIn will have a material impact on revenue and operating cash flow during the year ending December 31, 2014. In response to this and to help mitigate the impact of the loss of revenue, the Company is adjusting its business plan and focusing on its key areas of strength, including, but not limited to:

- Our ability to sell directly to all potential customers and earn 100% of each sale;
- Eliminate key account restrictions imposed on us during the effective time of the LinkedIn agreement;
- Benefit from new enhanced Equal Employment Opportunity-Office of Federal Contract Compliance Program regulations enhancing demand for our products and services;

- Benefit from the strength of our business foundation and management team; and
- Pursue potential acquisition opportunities in the recruitment industry.

### 3. Summary of Significant Accounting Policies

The accompanying unaudited condensed financial statements as of June 30, 2014 and for the three and six months then ended have been prepared in accordance with the accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and pursuant to the instructions to Form 10-Q and Article 8 of Regulation S-X of the Securities and Exchange Commission ("SEC") and on the same basis as the Company prepares its annual audited consolidated financial statements. The condensed balance sheet as of June 30, 2014, condensed statements of comprehensive loss for the three and six months ended June 30, 2014 and 2013, the condensed statements of cash flows for the six months ended June 30, 2014 and 2013, and the condensed statements of stockholders' equity for the six months ended June 30, 2014 are unaudited, but include all adjustments, consisting only of normal recurring adjustments, which the Company considers necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The results for the three and six months ended June 30, 2014 are not necessarily indicative of results to be expected for the year ending December 31, 2014 or for any future interim period. The condensed balance sheet at December 31, 2013 has been derived from audited financial statements; however, it does not include all of the information and notes required by U.S. GAAP for complete financial statements. The accompanying condensed financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2013, and notes thereto included in the Company's annual report on Form 10-K, which was filed with the SEC on March 27, 2014.

Professional Diversity Network, Inc.  
Condensed Notes to Financial Statements

**Accounting Estimates** - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Significant areas that required management to make estimates and assumptions that affect the amounts and disclosures in the financial statements include revenue recognition, valuation of goodwill, trade name and URL, costs capitalized to develop technology, the Company's estimated useful lives of assets and warrants granted in connection with financing transactions. Actual results could differ from those estimates.

**Significant Accounting Policies** - There have been no material changes to the Company's significant accounting policies as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as filed with the SEC on March 27, 2014.

**Short-Term Investments** - All highly liquid investments that have an original maturity of greater than 90 days but less than one year at the date of purchase are classified as short-term investments. The Company classifies short-term investments as held to maturity and carries them at amortized cost if the Company has the positive intent and ability to hold the securities to maturity. As of June 30, 2014, short-term investments consist of certificates of deposit, municipal bonds and corporate fixed income bonds.

**Advertising and Marketing Expenses** - Advertising and marketing expenses are expensed as incurred. For the three months ended June 30, 2014 and 2013, the Company incurred advertising and marketing expenses of approximately \$169,000 and \$216,000, respectively. For the six months ended June 30, 2014 and 2013, the Company incurred advertising and marketing expenses of approximately \$331,000 and \$395,000, respectively. These amounts are included in sales and marketing expenses in the accompanying statements of comprehensive loss.

**Income Taxes** - As a result of the Company's completion of its IPO, the Company's results of operations are taxed as a C Corporation. Prior to the IPO, the Company's operations were taxed as a limited liability company, whereby the Company elected to be taxed as a partnership and the income or loss was required to be reported by each respective member on their separate income tax returns. Therefore, no provision for income taxes has been provided in the accompanying condensed financial statements for periods prior to March 4, 2013 (the date on which the tax status changed to a C Corporation).

This change in tax status in 2013 to a taxable entity resulted in the recognition of deferred tax assets and liabilities based on the expected tax consequences of temporary differences between the book and tax basis of the Company's assets and liabilities as of the date of the IPO. This resulted in a net deferred tax benefit of \$512,589 and a net deferred tax expense of \$104,812 being recognized and included in the tax provision for the six months ended June 30, 2014 and 2013, respectively. The tax benefit and expense were determined using an effective tax rate of 40.6% for the periods ended June 30, 2014 and for the period from March 4, 2013 (the date on which the tax status changed to a C Corporation) to June 30, 2013.

The unaudited pro forma computation of income tax benefit included in the condensed statements of comprehensive loss, represents the tax effects that would have been reported had the Company been subject to U.S. federal and state income taxes as a corporation for all periods presented. Pro forma taxes are based upon the statutory income tax rates and adjustments to income for estimated permanent differences occurring during each period. Actual rates and expenses could have differed had the Company actually been subject to U.S. federal and state income taxes for all periods presented. Therefore, the unaudited pro forma amounts are for informational purposes only and are intended to be indicative of the results of operations had the Company been subject to U.S. federal and state income taxes as a corporation for all periods presented.

Fair Value of Financial Assets and Liabilities- Financial instruments, including cash and cash equivalents, short-term investments, accounts payable and accrued liabilities, are carried at historical cost. Management believes that the recorded amounts approximate fair value due to the short-term nature of these instruments.

The Company measures the fair value of financial assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The Company uses three levels of inputs that may be used to measure fair value:

Level 1 — quoted prices in active markets for identical assets or liabilities

Professional Diversity Network, Inc.  
Condensed Notes to Financial Statements

Level 2 — quoted prices for similar assets and liabilities in active markets or inputs that are observable

Level 3 — inputs that are unobservable (for example cash flow modeling inputs based on assumptions)

The following table presents a summary of fair value measurements for certain financial instruments measured at fair value on a recurring basis:

| Financial Instrument | Level | June 30,<br>2014 | December 31,<br>2013 |
|----------------------|-------|------------------|----------------------|
| Warrant liability    | 3     | \$ 71,689        | \$ 85,221            |

Level 3 liabilities are valued using unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the derivative liabilities. For fair value measurements categorized within Level 3 of the fair value hierarchy, the Company's accounting and finance department, who report to the Chief Financial Officer, determine its valuation policies and procedures. The development and determination of the unobservable inputs for Level 3 fair value measurements and fair value calculations are the responsibility of the Company's accounting and finance department and are approved by the Chief Financial Officer.

#### Level 3 Valuation Techniques:

Level 3 financial liabilities consist of warrant liabilities for which there is no current market for these securities such that the determination of fair value requires significant judgment or estimation. Changes in fair value measurements categorized within Level 3 of the fair value hierarchy are analyzed each period based on changes in estimates or assumptions and recorded as appropriate.

The Company uses the Black-Scholes option pricing model to value Level 3 financial liabilities at inception and on subsequent valuation dates. This model incorporates transaction details such as the Company's stock price, contractual terms, maturity, and risk free rates, as well as volatility.

A significant decrease in the volatility or a significant decrease in the Company's stock price, in isolation, would result in a significantly lower fair value measurement. Changes in the values of the derivative liabilities are recorded in "change in fair value of warrant liability" in the Company's condensed consolidated statements of operations.

As of June 30, 2014, there were no transfers in or out of Level 3 from other levels in the fair value hierarchy.

**Net Loss per Share** - The Company computes basic net loss per share by dividing net loss per share available to common stockholders by the weighted average number of common shares outstanding for the period and excludes the effects of any potentially dilutive securities. Diluted earnings per share, if presented, would include the dilution that would occur upon the exercise or conversion of all potentially dilutive securities into common stock using the "treasury stock" and/or "if converted" methods as applicable. The computation of basic net loss per share for the three and months ended June 30, 2014 and 2013 excludes the potentially dilutive securities summarized in the table below because their inclusion would be anti-dilutive.

|                                   | 2014    | 2013    |
|-----------------------------------|---------|---------|
| Warrants to purchase common stock | 131,250 | 131,250 |
| Stock options                     | 183,000 | -       |
|                                   | 314,250 | 131,250 |

#### Recently Issued Accounting Pronouncements

In July 2013, the FASB ASU, No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). ASU 2013-11 provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013, with an option for early adoption. The Company adopted ASU 2013-11 effective January 1, 2014 and the adoption did not have an impact on the condensed financial statements but may have an impact in future periods.

Professional Diversity Network, Inc.  
Condensed Notes to Financial Statements

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" (ASU 201-09). ASU 201-09 provides guidance for revenue recognition and affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets and supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition," and most industry-specific guidance. The core principle of ASU 2014-09 is the recognition of revenue when a company transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, companies will need to use more judgment and make more estimates than under the current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for fiscal years beginning after December 15, 2016 and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). Early adoption is not permitted. The Company is currently evaluating the method and impact the adoption of ASU 2014-09 will have on the Company's condensed financial statements and disclosures.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation" (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period ("ASU 2014-12"). ASU 2014-12 affects entities that grant their employees share-based payments in which terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The amendments in ASU 2014-12 require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU 2014-12 is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the method and impact the adoption of ASU 2014-12 will have on the Company's consolidated financial statements and disclosures.

#### 4. Capitalized Technology

Capitalized Technology, net is as follows:

|                              | June 30,<br>2014 | December 31,<br>2013 |
|------------------------------|------------------|----------------------|
| Capitalized cost:            |                  |                      |
| Balance, beginning of period | \$ 1,289,099     | \$ 734,291           |
| Additional capitalized cost  | 97,918           | 354,808              |
| Purchased technology         | -                | 200,000              |
| Balance, end of period       | \$ 1,387,017     | \$ 1,289,099         |
| Accumulated amortization:    |                  |                      |
| Balance, beginning of period | \$ 596,588       | \$ 331,401           |
| Provision for amortization   | 174,133          | 265,187              |
| Balance, end of period       | \$ 770,721       | \$ 596,588           |
| Capitalized Technology, net  | \$ 616,296       | \$ 692,511           |

Amortization expense of \$89,107 and \$56,125 for the three months ended June 30, 2014 and 2013, respectively, and \$174,133 and \$107,619 for the six months ended June 30, 2014 and 2013, respectively, is recorded in depreciation and

amortization expense in the accompanying condensed statements of comprehensive loss.

## 5. Accrued Expenses

Accrued expenses consist of the following:

|                                   | June 30,<br>2014 | December 31,<br>2013 |
|-----------------------------------|------------------|----------------------|
| Payroll liabilities               | \$ 92,914        | \$ 41,930            |
| License fee                       | 450,000          | -                    |
| Deferred payment from acquisition | 75,000           | 25,000               |
| Deferred rent                     | 9,288            | 13,932               |
| Sales and marketing               | 15,660           | 11,250               |
| Cost of services                  | 43,526           | 10,546               |
| Consulting                        | -                | 60,000               |
| Other                             | 23,851           | 25,804               |
|                                   | \$ 710,239       | \$ 188,462           |

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## 6. Commitments and Contingencies

**Lease Obligations** - The Company leases office space under two operating lease agreements. The Company leases approximately 4,600 square feet of office space for its headquarters. The lease provides for monthly rental payments of \$6,386 and is scheduled to expire on June 30, 2015. The Company also leases approximately 1,900 square feet of office space for its events business in Minnesota. The lease provides for monthly rental payments of \$2,551 and is scheduled to expire on September 30, 2014.

Rent expense, amounting to \$20,164 and \$17,755 for the three months ended June 30, 2014 and 2013, respectively, and \$45,577 and \$44,246 for the six months ended June 30, 2014 and 2013, respectively, is included in general and administrative expense in the condensed statements of comprehensive loss.

## 7. Warrant Liability

The common stock purchase warrants issued to the underwriters in the Company's IPO in March 2013 have certain cash settlement features that require them to be recorded as liability instruments. At issuance, a portion of the proceeds from the IPO were allocated to the value of the warrant and recorded as an offering cost, reducing the proceeds from the IPO. Accordingly, as a liability, the warrant obligations are adjusted to fair value at the end of each reporting period with the change in value reported in the statement of operations. Such fair values were estimated using the Black-Scholes option pricing model. The Company will continue to adjust the warrant liability for changes in fair value until the earlier of the exercise, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants.

The warrant liability was valued using the Black-Scholes option pricing model and the following assumptions on the following dates:

|                         | June 30,<br>2014 | December 31,<br>2013 |
|-------------------------|------------------|----------------------|
| Strike price            | \$ 10.00         | \$ 10.00             |
| Market price            | \$ 4.07          | \$ 4.61              |
| Expected life           | 4.68 years       | 5.17 years           |
| Risk-free interest rate | 1.62 %           | 0.86 %               |
| Dividend yield          | 0.00 %           | 0.00 %               |
| Volatility              | 43 %             | 39 %                 |
| Warrants outstanding    | 131,250          | 131,250              |
| Fair value of warrants  | \$ 71,689        | \$ 85,221            |

The fair value of the warrant liability decreased to \$71,689 at June 30, 2014 from \$85,221 at December 31, 2013. Accordingly, the Company decreased the warrant liability by \$13,532 to reflect the change in the fair value of the warrant instruments for the six month ended June 30, 2014, which is included in the accompanying condensed statements of comprehensive loss. The following table sets forth a summary of the changes in the fair value of our Level 3 financial liabilities that are measured at fair value on a recurring basis:

|                                            |             |
|--------------------------------------------|-------------|
| Beginning balance                          | \$ (85,221) |
| Decrease in net value of warrant liability | 13,532      |
| Ending balance                             | \$ (71,689) |

#### 8. Stockholders' Equity

Preferred Stock – The Company has no preferred stock issued. Our amended and restated certificate of incorporation and amended and restated bylaws include provisions that allow the Company's Board of Directors to issue, without further action by the stockholders, up to 1,000,000 shares of undesignated preferred stock.

Common Stock – The Company has one class of common stock outstanding with a total number of shares authorized of 25,000,000. As of June 30, 2014, the Company had 6,309,845 shares of common stock outstanding.

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**Share Repurchase Program** – On April 29, 2013, the Company announced that its Board of Directors authorized a share repurchase program pursuant to which the Company could repurchase up to \$1 million of its outstanding common stock. The program was renewed by the Board of Directors on November 30, 2013 for an additional six-month period expiring on May 31, 2014. The repurchases under the program were permitted to be made from time to time at prevailing market prices in open market or privately negotiated transactions, depending upon market conditions. The manner, timing and amount of any repurchases were determined by the Company based on an evaluation of market conditions, stock price and other factors. Under the program, the purchases were funded from available working capital, and the repurchased shares are held in treasury. The program did not obligate the Company to acquire any particular amount of common stock. As of June 30, 2014, the Company had acquired 8,382 shares of its outstanding common stock in exchange for \$37,117. The share repurchase has been recorded as treasury stock, at cost, in the accompanying condensed balance sheets at June 30, 2014 and December 31, 2013. The Company acquired 6,182 shares during the six months ended June 30, 2014 in exchange for \$25,862.

**Equity Incentive Plans** – Prior to the consummation of our IPO, we adopted the 2013 Equity Compensation Plan under which we reserved 500,000 shares of our common stock for the purpose of providing equity incentives to our employees, officers, directors and consultants including options, restricted stock, restricted stock units, stock appreciation rights, other equity awards, annual incentive awards and dividend equivalents. The plan provides for a maximum of 500,000 shares that could be acquired upon the exercise of a stock option or the vesting of restricted stock. The plan was approved by our stockholders prior to the consummation of our IPO.

The following table summarizes the Company's stock option activity for the six months ended June 30, 2014:

|                                 | Number of<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(in Years) | Aggregate<br>Intrinsic<br>Value |
|---------------------------------|----------------------|------------------------------------------|-----------------------------------------------------------------------|---------------------------------|
| Outstanding - December 31, 2013 | -                    | \$ -                                     | -                                                                     | \$ 0                            |
| Granted                         | 187,000              | 3.45                                     |                                                                       |                                 |
| Exercised                       | -                    | -                                        |                                                                       |                                 |
| Forfeited or Canceled           | (4,000)              | (3.45)                                   |                                                                       |                                 |
| Outstanding – June 30, 2014     | 183,000              | \$ 3.45                                  | 9.8                                                                   | \$ 113,460                      |
| Exercisable – June 30, 2014     | -                    | -                                        | -                                                                     | \$ -                            |

A summary of the changes in the Company's unvested stock options is as follows:

|                              | Number of<br>Options | Weighted<br>Average Grant<br>Date Fair<br>Value |
|------------------------------|----------------------|-------------------------------------------------|
| Unvested - December 31, 2013 | -                    | \$ -                                            |
| Granted                      | 187,000              | 1.65                                            |
| Vested                       | -                    | -                                               |
| Forfeited or Canceled        | (4,000)              | 1.65                                            |

|                          |         |    |      |
|--------------------------|---------|----|------|
| Unvested – June 30, 2014 | 183,000 | \$ | 1.65 |
|--------------------------|---------|----|------|

On March 31, 2014, the Company granted 187,000 stock options to certain directors, senior management and employees for future services. These options had a fair value of \$308,350 using the Black-Sholes option-pricing model with the following assumptions:

|                         |       |       |
|-------------------------|-------|-------|
| Risk-free interest rate | 2.02  | %     |
| Expected dividend yield | 0.00  | %     |
| Expected volatility     | 48.14 | %     |
| Expected term           | 6     | years |

The options are exercisable at an exercise price of \$3.45 per share over a ten-year term and vest over three years. The Company recorded \$25,696 as compensation expense during the three and six months ended June 30, 2014 pertaining to this grant.

Total unrecognized compensation expense related to unvested stock awards at June 30, 2014 amounts to \$276,608 and is expected to be recognized over a weighted average period of 2.75 years.

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## 9. Customer Concentration

The Company's revenues were historically highly dependent on two customers: LinkedIn and Apollo Education Group, Inc. ("Apollo Group" or "Apollo"). The Company anticipates that the end of its reseller relationship with LinkedIn will materially and adversely affect the Company's business, operating results and financial condition. Additionally, if Apollo seeks to renegotiate its agreement on terms less favorable to the Company and the Company accepts such unfavorable terms, or if the Company seeks to negotiate better terms but is unable to do so, then the Company's business, operating results and financial condition would be materially and adversely affected. As discussed below, our agreement with LinkedIn terminated on March 29, 2014.

The following table shows significant concentrations in our revenues and accounts receivable for the periods indicated.

|          | Percentage of Revenue<br>During the Three<br>Months Ended |   |      |   | Percentage of Revenue<br>During the Six<br>Months Ended |   |      |   | Percentage of Accounts<br>Receivable at |   |      |   |
|----------|-----------------------------------------------------------|---|------|---|---------------------------------------------------------|---|------|---|-----------------------------------------|---|------|---|
|          | June 30,                                                  |   |      |   | June 30,                                                |   |      |   | December                                |   |      |   |
|          | 2014                                                      |   | 2013 |   | 2014                                                    |   | 2013 |   | 2014                                    |   | 2013 |   |
| LinkedIn | 0                                                         | % | 51   | % | 22                                                      | % | 53   | % | 0                                       | % | 41   | % |
| Apollo   | 34                                                        | % | 39   | % | 31                                                      | % | 39   | % | 32                                      | % | 19   | % |

## Recruitment Revenue

Revenues from the Company's recruitment services are recognized when the services are performed, evidence of an arrangement exists, the fee is fixed or determinable and collectability is probable. The Company's recruitment revenue is derived from the Company's agreements through single and multiple job postings, recruitment media, talent recruitment communities, basic and premier corporate memberships, hiring campaign marketing and advertising, e-newsletter marketing and research and outreach services.

On November 12, 2012, we entered into a diversity recruitment partnership agreement with LinkedIn, which became effective on January 1, 2013 and terminated on March 29, 2014. Pursuant to our agreement, LinkedIn could resell diversity-based job postings to its customers, as well as recruitment advertising on our websites. Our agreement with LinkedIn provided that LinkedIn make fixed quarterly payments to us in the amount of \$500,000 per quarter. The fixed quarterly payments were payable regardless of sales volumes or any other performance metric. Under the LinkedIn agreement, we also could have earned commissions for sales of our services by LinkedIn in excess of certain thresholds. We do not obtain information about commissions earned from LinkedIn, if any, until within 60 days following the end of any fiscal quarter. Accordingly, any commission earned from LinkedIn sales during the fiscal quarter ended March 31, 2014 is reflected in our financial statements for the subsequent quarter, subject to the applicable revenue recognition criteria being met. As a result of the termination of the agreement, LinkedIn is no longer a reseller of our products or services and we no longer receive the fixed quarterly payments of \$500,000 or have the potential to earn additional commission revenue from LinkedIn. As part of the termination agreement, we no longer have post termination restrictions on our ability to sell any employers our diversity recruitment services. Additionally, as part of our termination with LinkedIn, we will provide ongoing job postings and reporting for those employers to whom LinkedIn sold our diversity recruitment services. We are not restricted from entering into a direct recruitment relationship with those companies that are using our products and services via the LinkedIn reseller

agreement. We did not earn a commission from LinkedIn during the three and six months ended June 30, 2014 and 2013. Our revenue derived from the LinkedIn contract during the three months ended June 30, 2014 and 2013 was \$0 and \$500,000, respectively, and \$494,444 and \$1,000,000 for the six months ended June 30, 2014 and 2013, respectively.

Recruitment revenue includes revenue recognized from direct sales to customers for recruitment services and events as well as revenue from LinkedIn and the Company's direct eCommerce sales.

On September 30, 2013, the Company enhanced its diversity recruitment offerings by acquiring Personnel Strategies, Inc. ("PSI"), a company that had been operating diversity focused job fairs throughout the United States for over 20 years. PSI is now being operated as the events division of the Company, creating networking events that assist corporations in their compliance initiatives, while providing diverse professionals with face-to-face time with corporate recruiters. Revenue from the events business was \$144,947 and \$0 for the three months ended June 30, 2014 and 2013, respectively, and \$245,130 and \$0 for the six months ended June 30, 2014 and 2013, respectively.

On June 30, 2014, the Company entered into Licensing Agreements with AudioEye, Inc. which gives the Company certain rights to market, sell, distribute and incorporate into its services the proprietary software product known as Audio Internet within the United States to its current and future customers. Audio Internet is a technology that utilizes patented architecture to deliver a fully accessible audio equivalent of a visual website or mobile website in a compliant format that can be navigated, utilized, interacted with and transacted from without the use of a monitor or mouse.

The first licensing agreement ("First Agreement") allows the Company to sell the products to customers in the private sector, corporate and enterprise online jobs posting and e-recruiting markets. The First Agreement specifically excludes sales to SAP AG and Monster Worldwide, Inc. The First Agreement gives the Company exclusive rights to sell within the United States for the first twelve months and on a non-exclusive basis thereafter. The Company agreed to pay AudioEye, Inc. a license fee of \$225,000 for the license and a royalty fee of 12% of revenue generated from the sales and/or licensing of the Audio Internet product.

The second licensing agreement ("Second Agreement") allows the Company to sell the products to customers that are Federal, State or local governmental entities (excluding SAP AG and Monster Worldwide, Inc.) within the United States on an exclusive basis for the first twelve months and a non-exclusive basis thereafter. The Company agreed to pay AudioEye, Inc. a license fee of \$225,000 for the license and a royalty fee of 12% of revenue generated from the sales and/or licensing of the Audio Internet product.

In addition the Company entered into a two year Sales Representation Agreement with AudioEye, Inc. which designates the Company as the exclusive agent of the product within the markets for twelve months and a non-exclusive agent thereafter. AudioEye, Inc. will pay the Company a non-refundable service fee of \$450,000 for marketing and sales services plus a commission of 25% of gross service and support fees billed to the end users by Audioeye, Inc.

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Consumer Advertising and Consumer Marketing Solutions Revenue

The Company provides career opportunity services to our various partner organizations and to Apollo Group, the parent company of The University of Phoenix, through advertising and job postings on their websites. We work with our partners and Apollo to develop customized websites and job boards where the partners and Apollo can generate advertising, job postings and career services to their members, students and alumni. Revenue is recognized for Apollo ratably over the life of the contract. Partner revenue is recognized as jobs are posted to their hosted sites.

In September 2011, the Company entered into an agreement with Apollo that provides for a fixed monthly fee of \$116,667 for services and technical solutions provided by the Company to the University of Phoenix and its students and alumni. The agreement may be renewed annually. The agreement was most recently renewed on February 14, 2014 and will expire on February 28, 2015, unless it is renewed. The primary service provided is for recruitment solutions for the University of Phoenix student and alumni career services. The Company recognized revenue under this agreement in the amount of \$350,000 during the three months ended June 30, 2014 and 2013 and \$700,000 during the six months ended June 30, 2014 and 2013.

10. Subsequent Events

On July 11, 2014, the Company, NAPW Merger Sub Inc., a newly formed Delaware corporation and wholly-owned subsidiary of the Company ("Merger Sub"), NAPW, Inc., a New York corporation ("NAPW"), and Matthew B. Proman, the sole shareholder of NAPW ("Proman"), entered into an Agreement and Plan of Merger (the "Merger Agreement"). The Merger Agreement provides for, among other things, a business combination whereby NAPW will merge with and into Merger Sub, with Merger Sub as the surviving entity (the "Merger"). As a result of the Merger, the separate corporate existence of NAPW will cease and Merger Sub will continue as the surviving corporation, will be a wholly-owned subsidiary of the Company, and will be renamed "NAPW, Inc.". At the effective time of the Merger, all shares of common stock of NAPW issued and outstanding immediately prior to the effective time of the Merger will be converted into and become the right to receive 5,110,975 shares of the Company's common stock, which will be issued to Proman as NAPW's sole shareholder. In addition, pursuant to separate subscription agreements, 959,096 shares will be issued to Star Jones, NAPW's President and National Spokeswoman and 239,774 shares will be issued to Christopher Wesser, NAPW's General Counsel, as set forth in the Merger Agreement. Also, at the effective time of the Merger, the Company, as additional consideration, will pay to Proman, in cash, \$3,450,000 and issue to Proman (i) a promissory note in the original principal amount of \$550,000, (ii) an option to purchase 183,000 shares of the Company's common stock at a price of \$3.45 per share, (iii) a warrant to purchase 50,000 shares of the Company's common stock at a price of \$4.00 per share and (iv) a warrant to purchase 131,250 shares of the Company's common stock at a price of \$10.00 per share (collectively, the "Option Consideration"). In consideration for its services as financial advisor to the Company, at the effective time of the Merger, the Company will also issue to Aegis Capital Corp. a warrant to purchase 50,000 shares of the Company's common stock with an exercise price of \$4.00 per share. The issuance of the 6,309,845 shares as consideration for the Merger will dilute the ownership and voting interests of the Company's existing stockholders. Upon the issuance of such shares and the Option Consideration in connection with the Merger, the recipients will own 50% of the Company's issued and outstanding common stock and 50% of the Company's common stock on a fully-diluted basis. Therefore, the ownership and voting interests of the Company's existing stockholders will be proportionately reduced. The Company is required to continue to operate its business in the ordinary course pending the merger and not take certain specified actions prior to the completion of the proposed merger.

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

The following discussion should be read in conjunction with our Unaudited Financial Statements, including the notes to those statements, included elsewhere in this Quarterly Report. This section and other parts of this Quarterly Report on Form 10-Q (this “Quarterly Report”) contain forward-looking statements within the meaning of Section 27A of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 concerning our future results of operations and financial position, business strategy and plans and our objectives for future operations. In some cases, you can identify forward-looking statements by the following words: “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “plan,” “potential,” “predict,” “project,” “should,” “will,” “would,” or the negative of the other comparable terminology, although not all forward-looking statements contain these words. These statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry’s results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements. Although we believe that we have a reasonable basis for each forward-looking statement contained in this Quarterly Report, we caution you that these statements are based on a combination of facts and factors currently known by us and our projections of the future, about which we cannot be certain. Such risks and uncertainties include, among others, those discussed in “Item 1A - Risk Factors” of our Annual Report on Form 10-K as filed with the SEC on March 27, 2014, as well as in our condensed financial statements, related notes, and the other financial information appearing elsewhere in this Quarterly Report and our other filings with the Securities and Exchange Commission, or the SEC. These factors could cause actual results to differ materially from the results anticipated by these forward-looking statements. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. The forward-looking statements in this Quarterly Report speak only as of the date they were made. We do not intend, and undertake no obligation, to update any of our forward-looking statements to reflect actual results or future events or circumstances. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Unless we specify otherwise, all references in this Quarterly Report to “Professional Diversity Network,” “we,” “our,” “us” and the “Company” refer to Professional Diversity Network, LLC d/b/a iHispano.com prior to the consummation of our reorganization (from an Illinois limited liability company into a Delaware corporation) on March 5, 2013, and Professional Diversity Network, Inc. after our reorganization.

For purposes of this Quarterly Report, unless the context clearly dictates otherwise, all references to “professional(s)” means any person interested in the company’s websites presumably for the purpose of career advancement or related benefits offered by the Company, whether or not such person is employed and regardless of the level of education or skills possessed by such person. The Company does not impose any selective or qualification criteria on membership and the term “professional(s)” as used in this Quarterly Report should be interpreted accordingly. In addition, the Company does not verify that any member of a particular Company website qualifies as a member of the ethnic, cultural or other group identified by that website. References to “user(s)” means any person who visits one or more of our websites and “our member(s)” means an individual user who has created a member profile on that website as of the date of measurement. If a member is inactive for 24 months then such person will be automatically de-registered from our database. The term “diverse” (or “diversity”) is used throughout this Annual Report to include communities that are distinct based on a wide array of criteria which may change from time to time, including ethnic, national, cultural, racial, religious or gender classification.

Overview

Professional Diversity Network develops and operates online professional networking communities dedicated to serving diverse professionals in the United States and employers seeking to hire diverse talent. Our networking communities harness our relationship recruitment methodology to facilitate and empower professional networking within common affinities. We believe that those within a common affinity often are more aggressive in helping others within their affinity progress professionally. The Company operates these relationship recruitment affinity groups within the following sectors: Women, Hispanic-Americans, African-Americans, Asian-Americans, Disabled, Military Professionals, Lesbians, Gay, Bisexual and Transgender (LGBT), and Student and Graduates seeking to transition from education to career. Our online platform provides employers a means to identify and acquire diverse talent and assist them with their efforts to comply with the Equal Employment Opportunity-Office of Federal Contract Compliance Program ("OFCCP").

As of June 30, 2014, the Company had approximately 3,170,000 registered users. We expect that our continued membership growth will enable us to further develop our menu of online professional diversity networking and career placement solutions. Additionally, the Company has established systems to distribute jobs in an OFCCP compliant manner to career agencies, including those of state and local governments.

The Company added over 523,000 registered users during the six months ended June 30, 2014, representing an increase of total registered users of 19.8% from December 31, 2013.

We currently provide registered users with access to our websites at no cost, a strategy which we believe will allow us to continue to grow our membership base and promote high levels of member engagement for the mutual benefit of members and employers.

The Company continues to expand its partnership relationships with key strategic alliances that we believe are valuable to our core clients. The Company currently maintains relationships with the following key strategic allies: the National Black MBA Association, National Urban League, the National Association for the Advancement of Colored People, VetJobs, DisabledPersons.com, a leading not-for-profit organization serving employment needs of people with disabilities, National Able Veterans Exchange, Leave No Veteran Behind, ALPFA, an organization dedicated to building Latino business leaders, Latino(a)s in Tech Innovation & Social Media, Illinois Hispanic Nursing Association, Women in Biology, Black Sales Journal, Ebony Magazine and numerous others. The Company considers its partner alliances to be a key value to its clients because it enables the Company to expand its job distribution and outreach efforts.

During the first quarter of 2014, the Company launched its Diversity Jobs Report, which provides statistical data specific to the nation's employment situation for various workforce segments by a range of criteria such as education, industry sector and geography. The report also includes a new Diversity Jobs Index that sheds light on the monthly employment condition for women, veterans, disabled persons, Hispanics, African Americans, Asian Americans and members of the LGBT community.

During the third quarter of 2013, the Company enhanced its Employer Recruitment Intelligent Compliance Assistance ("ERICA") product. The ERICA product was designed to align corporate compliance efforts with the recently modified diversity recruitment requirements of the OFCCP. The Company believes it is well positioned to provide recruiting and recordkeeping solutions to address these changes in an OFCCP-compliant manner. The Company's service delivery includes a screen shot capture of jobs posted to official State Job Boards, Employment Service Delivery Systems and other locations. Additionally the Company has significant diversity recruitment outreach via its own network of diverse sites and its numerous partner distribution sites.

On July 11, 2014, the Company, NAPW Merger Sub Inc., a newly formed Delaware corporation and wholly-owned subsidiary of the Company ("Merger Sub"), NAPW, Inc., a New York corporation ("NAPW"), and Matthew B. Proman, the sole shareholder of NAPW ("Proman"), entered into an Agreement and Plan of Merger (the "Merger Agreement"). The Merger Agreement provides for, among other things, a business combination whereby NAPW will merge with and into Merger Sub, with Merger Sub as the surviving entity (the "Merger"). As a result of the Merger, the separate corporate existence of NAPW will cease and Merger Sub will continue as the surviving corporation, will be a wholly-owned subsidiary of the Company, and will be renamed "NAPW, Inc." At the effective time of the Merger, all shares of common stock of NAPW issued and outstanding immediately prior to the effective time of the Merger will be converted into and become the right to receive 5,110,975 shares of the Company's common stock, which will be issued to Proman as NAPW's sole shareholder. In addition, pursuant to separate subscription agreements, 959,096 shares will be issued to Star Jones, NAPW's President and National Spokeswoman, and 239,774 shares will be issued to Christopher Wesser, NAPW's General Counsel, as set forth in the Merger Agreement. Also, at the effective time of the Merger, the Company, as additional consideration, will pay to Proman, in cash, \$3,450,000 and issue to Proman (i) a promissory note in the original principal amount of \$550,000, (ii) an option to purchase 183,000 shares of the Company's common stock at a price of \$3.45 per share, (iii) a warrant to purchase 50,000 shares of the Company's common stock at a price of \$4.00 per share and (iv) a warrant to purchase 131,250 shares of the Company's common stock at a price of \$10.00 per share (collectively, the "Option Consideration"). In consideration for its services as financial advisor to the Company, at the effective time of the Merger, the Company will also issue to Aegis Capital Corp. a warrant to purchase 50,000 shares of the Company's common stock with an exercise price of \$4.00 per share. The issuance of the 6,309,845 shares as consideration for the Merger will dilute the ownership and voting interests of the Company's existing stockholders. Upon the issuance of such shares and the Option Consideration in connection

with the Merger, the recipients will own 50% of the Company's issued and outstanding common stock and 50% of the Company's common stock on a fully-diluted basis. Therefore, the ownership and voting interests of the Company's existing stockholders will be proportionately reduced. The Company is required to continue to operate its business in the ordinary course pending the merger and not take certain specified actions prior to the completion of the proposed merger. As a result, the merger poses certain risks to the Company during the pendency of the transaction.

Concurrently with the execution of the Merger Agreement, NAPW entered into a voting agreement (the "Voting Agreement") with certain stockholders of the Company who, in the aggregate, hold shares representing approximately 58.6% of the outstanding voting power of the Company. Pursuant to the Voting Agreement, the Company stockholders party thereto have agreed to vote the shares of Company common stock held by them in favor of the Merger and the other transactions contemplated by the Merger Agreement, and against, among other things, alternative business combination transactions. Such stockholders further agreed to certain restrictions on the disposition of such shares of common stock, subject to the terms and conditions contained therein. Pursuant to the terms of the Voting Agreement, the Voting Agreement will terminate upon the earlier of the consummation of the Merger or the termination of the Merger Agreement in accordance with its terms.

Revenue. The Company realized \$1,032,287 in total revenue during the three month period ended June 30, 2014, compared to \$976,920 in the same prior year period, representing an increase of 5.7%, attributable primarily to an increase in revenue from direct sales, offset by a decrease in our LinkedIn revenue (see below). The sales and marketing team, launched last year at Professional Diversity Network, is executing its sales plan to bring on numerous new direct relationships with employers who seek to recruit diverse talent. We have also experienced early adoption of our OFCCP compliance product services by a number of customers. By combining diversity recruitment advertising with job postings and compliance services, the Company is able to deliver a valuable, cost effective and comprehensive solution for businesses subject to OFCCP compliance. The technology that enabled the Company to effectively compete in OFCCP job distribution was enhanced by our June 14, 2013 purchase of proprietary software technology from CareerImp Inc., which related to the development of career guidance tools for job seekers.

We generate revenue through numerous sources all of which involve recruitment services. We offer job postings, recruitment advertising, semantic search technology, career and networking events. We also license our recruitment technology platform. We currently have over 500 companies utilizing our products and services, either directly or through our legacy LinkedIn reseller agreement. For the six months ended June 30, 2014, approximately 6% of our revenue was transacted online via ecommerce. The majority of our sales are consummated via direct interaction with our diversity recruitment sales professionals.

The Company's revenues were historically highly dependent on two customers: LinkedIn and Apollo Group. Apollo Group is the parent company of the University of Phoenix, the country's largest private university offering more than 100-degree programs as well as Internet curriculum in most countries around the world. The end of the Company's reseller relationship with LinkedIn during the first quarter of 2014, under which LinkedIn previously paid fixed quarterly payments of \$500,000 to the Company, has materially and adversely affected the Company's business, operating results and financial condition. Additionally, if Apollo seeks to renegotiate its agreement on terms less favorable to the Company and the Company accepts such unfavorable terms, or if the Company seeks to negotiate better terms but is unable to do so, then the Company's business, operating results and financial condition would be materially and adversely affected. These two customers accounted for 53%, or approximately \$1.2 million, of total gross revenues, with LinkedIn representing 22% and Apollo Group representing 31% of total gross revenues for the six months ended June 30, 2014.

Pursuant to the agreement with Apollo Group renewed on February 14, 2014, the Company is paid a fixed monthly fee of \$116,667 for services and technical solutions provided by the Company to the University of Phoenix and its students and alumni. The Company primarily provides recruitment solutions for the University of Phoenix student and alumni career services.

The Company's strategy is to continue to diversify its customer base and thus its sources of revenue. Our sales and marketing team, newly launched last year, is experiencing meaningful growth in its ability to transact business. As of June 30, 2014, the Company has developed a team of 26 sales and marketing professionals. Revenue recognized from direct sales of all services and events to businesses (exclusive of revenue from LinkedIn and Apollo) was approximately \$682,000 and \$1,075,000 for the three and six months ended June 30, 2014, respectively, compared to \$92,000 and \$158,000 for the three and six months ended June 30, 2013, respectively, representing an increase of 642% and 582%, respectively.

While we recognize revenue ratably as earned over the life of the contracts we sell, the Company tracks gross revenues booked for its services originating from the Company's direct sales force on a quarterly basis. Direct revenues booked during the second quarter of 2014 for all services and events were \$802,000 (including \$225,000 of bookings from our events division), compared to \$105,000 in the second quarter of 2013, representing an increase of 663%.

Recruitment Services. The majority of our revenue is generated from job recruitment advertising. For the six months ended June 30, 2014, the three months ended June 30, 2014 and the fiscal year ended December 31, 2013, approximately 62%, 57% and 61% of our revenue was generated from recruitment advertising, respectively.

We entered into a diversity recruitment partnership agreement with LinkedIn on November 12, 2012, which became effective on January 1, 2013. Pursuant to the agreement, LinkedIn resold to its customers, diversity-based job postings and recruitment advertising on our websites. Our agreement with LinkedIn provided that LinkedIn made fixed quarterly payments to us in the amount of \$500,000 per quarter and paid us commissions for sales of our services in excess of certain thresholds. We did not earn any commission from LinkedIn sales during the fiscal quarter ended March 31, 2014 or during the fiscal year ended December 31, 2013. The agreement with LinkedIn terminated on March 29, 2014 and as a result, LinkedIn is no longer a reseller of our products or services and we will not receive the fixed quarterly payments of \$500,000 or have the potential to earn additional commission revenue from LinkedIn. As part of the termination agreement, we no longer have post termination restrictions on our ability to sell any employers our diversity recruitment services. Additionally, as part of our termination with LinkedIn, we will provide ongoing job postings and reporting for those employers to whom LinkedIn sold our diversity recruitment services. We are not restricted from entering into a direct recruitment relationship with those companies that are using our products and services via the LinkedIn reseller agreement.

#### Seasonality

Our quarterly operating results are affected by the seasonality of employers' businesses. Historically, demand for employment hiring is lower during the first quarter and second quarters of the year and increases during the third and fourth quarters.

## Costs and Expenses

We maintained a relatively consistent level of expenditures on sales and marketing during the three months ended June 30, 2014 of approximately \$763,000, compared to approximately \$796,000 for the three months ended March 31, 2014. This is primarily attributable to our investment in building a sales and marketing group that can deliver long-term success. During the three months ended June 30, 2014, the Company terminated the employment of certain members of the sales team and replaced them with sales executives experienced in online recruitment. The Company believes that it will benefit from these new team members in the coming months and years. In connection with the termination of the LinkedIn agreement effective March 29, 2014, the Company now has the freedom to sell those 1,000 accounts formerly restricted by the LinkedIn agreement. The Company maintains a business relationship with LinkedIn with respect to certain LinkedIn clients that utilize the Company's OFCCP compliance services.

We believe there are more than 10,000 companies that are potential business partners of Professional Diversity Network. We also believe that our year over year growth of over 663% for the second quarter of 2014 via our direct sales model, while not necessarily indicative of future results, does indicate that our investment in our new sales and marketing team is beginning to have a positive impact on the Company. Building a new team takes time and resources and we believe that our investment in this team now will enable us to diversify our client base, increase our revenue and create value for our shareholders. We feel that the size of the current team is sufficient to grow our direct sales revenues significantly, without further substantial investments in sales personnel.

## Results of Operations

The following tables set forth our results of operations for the periods presented (certain items may not foot due to rounding). The period-to-period comparison of financial results is not necessarily indicative of future results.

|                                                               | Three Months Ended June 30,<br>2014<br>2013<br>(in thousands) |           | Change<br>(Dollars) | Change<br>(Percent) |    |
|---------------------------------------------------------------|---------------------------------------------------------------|-----------|---------------------|---------------------|----|
| Revenues                                                      |                                                               |           |                     |                     |    |
| Recruitment services                                          | \$ 585                                                        | \$ 556    | \$ 29               | 5.2                 | %  |
| Consumer advertising and consumer marketing solutions revenue | 447                                                           | 421       | 26                  | 6.3                 | %  |
| Total revenues                                                | 1,032                                                         | 977       | 55                  | 5.7                 | %  |
| Costs and expenses:                                           |                                                               |           |                     |                     |    |
| Cost of services                                              | 396                                                           | 247       | 149                 | 60.2                | %  |
| Sales and marketing                                           | 763                                                           | 576       | 187                 | 32.5                | %  |
| General and administrative                                    | 572                                                           | 527       | 45                  | 8.5                 | %  |
| Depreciation and amortization                                 | 94                                                            | 61        | 33                  | 54.6                | %  |
| Gain on sale of property and equipment                        | 0                                                             | 0         | 0                   | 0.0                 | %  |
| Total costs and expenses                                      | 1,825                                                         | 1,411     | 414                 | 29.3                | %  |
| Loss from operations                                          | (792 )                                                        | (434 )    | (359 )              | 82.7                | %  |
|                                                               |                                                               |           |                     |                     |    |
| Other income, net                                             | 1                                                             | 9         | (8 )                | (88.9               | %) |
| Change in fair value of warrant liability                     | (30 )                                                         | 200       | (231 )              | (115.1              | %) |
| Income tax benefit                                            | (333 )                                                        | (91 )     | (242 )              | 266.6               | %  |
| Net loss                                                      | \$ (488 )                                                     | \$ (133 ) | \$ (355 )           | 266.6               | %  |



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|                                                               | Six Months Ended June 30, |           | Change    | Change    |    |
|---------------------------------------------------------------|---------------------------|-----------|-----------|-----------|----|
|                                                               | 2014                      | 2013      | (Dollars) | (Percent) |    |
|                                                               | (in thousands)            |           |           |           |    |
| Revenues                                                      |                           |           |           |           |    |
| Recruitment services                                          | \$ 1,401                  | \$ 1,092  | \$ 310    | 28.4      | %  |
| Consumer advertising and consumer marketing solutions revenue | 868                       | 805       | 64        | 7.9       | %  |
| Total revenues                                                | 2,270                     | 1,897     | 373       | 19.7      | %  |
| Costs and expenses:                                           |                           |           |           |           |    |
| Cost of services                                              | 762                       | 486       | 276       | 56.8      | %  |
| Sales and marketing                                           | 1,560                     | 1,032     | 528       | 51.1      | %  |
| General and administrative                                    | 1,108                     | 948       | 160       | 16.8      | %  |
| Depreciation and amortization                                 | 185                       | 116       | 69        | 59.1      | %  |
| Gain on sale of property and equipment                        | 0                         | (5 )      | 5         | (100.0    | %) |
| Total costs and expenses                                      | 3,614                     | 2,577     | 1,037     | 40.2      | %  |
| Loss from operations                                          | (1,344 )                  | (681 )    | (663 )    | 97.5      | %  |
| Other income (expense), net                                   | 67                        | (141 )    | 208       | (147.8    | %) |
| Change in fair value of warrant liability                     | 14                        | 311       | (298 )    | (95.7     | %) |
| Income tax (benefit) expense                                  | (513 )                    | 105       | (617 )    | (589.1    | %) |
| Net loss                                                      | \$ (751 )                 | \$ (615 ) | \$ (136 ) | 22.1      | %  |

## Revenue

The following tables set forth our results of operations for the periods presented as a percentage of revenue for those periods. The period to period comparison of financial results is not necessarily indicative of future results.

|                                                               | For the Three Months Ended |   |      |   | For the Six Months Ended |   |      |   |
|---------------------------------------------------------------|----------------------------|---|------|---|--------------------------|---|------|---|
|                                                               | June 30,                   |   |      |   | June 30,                 |   |      |   |
|                                                               | 2014                       |   | 2013 |   | 2014                     |   | 2013 |   |
| Percentage of revenue by product:                             |                            |   |      |   |                          |   |      |   |
| Recruitment services                                          | 57                         | % | 57   | % | 62                       | % | 58   | % |
| Consumer advertising and consumer marketing solutions revenue | 43                         | % | 43   | % | 38                       | % | 42   | % |

Total recruitment services revenue increased 5.2% and 28.4%% for the three and six months ended June 30, 2014, respectively, compared to the same periods in the prior year. Revenue from our recruitment solutions includes \$0 and \$500,000 for the three months ended June 30, 2014 and 2013, respectively, and \$494,000 and \$1,000,000 for the six months ended June 30, 2014 and 2013, respectively, pursuant to our LinkedIn agreement, which expired on March 29, 2014. In September 2013, we purchased the assets of Personnel Strategies, Inc. ("PSI"). PSI had been operating diversity focused job fairs throughout the United States for over 20 years and is now being operated as the events division of the Company. Revenues for the three and six months ended June 30, 2014 includes \$145,000 and \$245,000, respectively, of revenues generated from our events division. Additionally, during the three months ended June 30, 2014 and 2013, we recognized \$350,000 and \$45,000, respectively, of revenues related to direct sales of our recruitment services. During the six months ended June 30, 2014 and 2013, we recognized \$530,000 and \$69,000, respectively, of revenues related to direct sales of our recruitment services. The increase in direct sales is primarily

attributable to the successful execution by our sales and marketing team, of its sales plan to bring on numerous new direct relationships with employers who seek to recruit diverse talent. We have also experienced early adoption of our OFCCP compliance product services by a number of customers. Additionally, direct sales of our recruitment services were positively impacted as a result of our termination agreement with LinkedIn, since we no longer have post termination restrictions on our ability to sell any employers our diversity recruitment services and we are not restricted from entering into a direct recruitment relationship with those companies that are using our products and services via the LinkedIn reseller agreement.

Revenue from our consumer advertising and consumer marketing solutions was \$447,000 and \$868,000 for the three and six months ended June 30, 2014, respectively, compared to \$421,000 and \$805,000 for the three and six months ended June 30, 2013. The year over year increase was primarily the result of an increase in partner sales, which amounted to \$97,000 and \$168,000 for the three and six months ended June 30, 2014, compared to \$36,000 and \$66,000 for the three and six months ended June 30, 2013, resulting from the addition of new partners. The revenue from our Apollo Education to Careers Agreement, which consists of a fixed monthly fee of \$116,667, remained the same.

## Operating Expenses

Cost of services expense: Cost of services expense increased \$149,000 and \$276,000 during the three and six months ended June 30, 2014, respectively, compared to the three and six months ended June 30, 2013. The increase in cost of services for the three and six months ended June 30, 2014 was mainly due to \$120,000 and \$217,000, respectively, of direct costs incurred in connection with our events division and a \$24,000 and \$46,000 increase in revenue sharing expenses during the three and six months ended June 30, 2014, respectively.

Sales and marketing expense: Sales and marketing expense for the three months ended June 30, 2014 was \$763,000, an increase of \$187,000, or 32%, compared to \$576,000 for the three months ended June 30, 2013. Sales and marketing expense for the six months ended June 30, 2014 was \$1,560,000, an increase of \$528,000, or 51%, compared to \$1,032,000 for the six months ended June 30, 2013. The increase primarily consisted of an increase of \$236,000 and \$570,000 for the three and six months ended June 30, 2014, respectively, in sales and marketing salaries, commissions and benefits, offset by a decrease in marketing and advertising expense of \$47,000 and \$64,000 for the three and six months ended June 30, 2014, respectively.

General and administrative expense: General and administrative expenses increased \$45,000 and \$160,000 during the three and six months ended June 30, 2014, respectively, compared to the three and six months ended June 30, 2013, primarily due to (1) an increase in certain public company expenses, such as directors and officers insurance, investor relations, filing fees, franchise tax fees and registration fees, of \$25,000 and \$141,000 for the three and six months ended June 30, 2014, respectively, (2) stock based compensation expense of \$26,000 incurred in connection with the granting of stock options to certain members of management and employees and (3) an increase of \$86,000 and \$26,000 in personnel expenses for the three and six months ended June 30, 2014, respectively, mainly due to the hiring of additional staff. Additionally, in connection with the acquisition of PSI, we committed to pay the former chief executive officer an additional \$100,000 on each of September 20, 2014 and 2015 contingent upon his continued employment with us on each of those respective dates. We recorded an expense of \$25,000 and \$50,000 related to these contingent liabilities during the three and six months ended June 30, 2014, respectively. The increase was offset by a decrease in professional fees of \$133,000 and \$85,000 for the three and six months ended June 30, 2014, respectively.

Depreciation and amortization expense: Depreciation and amortization expense increased \$33,000 and \$69,000 during the three and six months ended June 30, 2014, respectively, compared to the three and six months ended June 30, 2013. The increase was primarily due to a \$33,000 and \$66,000 increase in amortization expense for the three and six months ended June 30, 2014, respectively, due to the additions to capitalized software relating to web product platform to support emerging technologies and to the acquired software technology from CareerImp Inc. in June 2013.

## Other Income (Expenses)

Other income for the three and six months ended June 30, 2014 mainly consists of interest earned on our short-term investments. Other expense for the six months ended June 30, 2013 is primarily attributable to the retirement of debt previously owed to certain shareholders of the Company that was exchanged for shares of our common stock upon our reorganization on March 4, 2013.

## Change in Fair Value of Warrant Liability

The change in the fair value of the warrant liability is related to the common stock purchase warrants issued to underwriters in the Company's IPO on March 4, 2013. We recorded a non-cash (loss)/gain of (\$30,000) and \$14,000, during the three and six months ended June 30, 2014, respectively, and non-cash gains of \$200,000 and \$311,000 during the three and six months ended June 30, 2013, respectively, related to changes in the fair value of our warrant

liability liabilities. The change in the fair value of our warrant liability was primarily the result of changes in our stock price.

#### Income Tax (Benefit) Expense

As a result of the Company's completion of its IPO, the Company's results of operations are taxed as a C Corporation. Prior to the IPO, the Company's operations were taxed as a limited liability company, whereby the Company elected to be taxed as a partnership and the income or loss was required to be reported by each respective member on their separate income tax returns. Therefore, no provision for income taxes was recorded for periods prior to March 4, 2013.

This change in tax status to a taxable entity resulted in the recognition of deferred tax assets and liabilities based on the expected tax consequences of temporary differences between the book and tax basis of the Company's assets and liabilities at the date of the IPO. This resulted in a net deferred tax (benefit) expense of (\$513,000) and \$105,000 being recognized and included in the tax provision for the six months ended June 30, 2014 and 2013, respectively. The tax (benefit) expense was determined using an effective tax rate of 40.6% for the six months ended June 30, 2014 and for the period from March 4, 2013 (the date on which the tax status changed to a C Corporation) to June 30, 2013.

## Critical Accounting Policies and Estimates

On April 5, 2012, the JOBS Act was signed into law. The JOBS Act contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. As an “emerging growth company,” we may delay adoption of new or revised accounting standards applicable to public companies until the earlier of the date that (i) we are no longer an emerging growth company or (ii) we affirmatively and irrevocably opt out of the extended transition period for complying with such new or revised accounting standards. We have elected to take advantage of the benefits of this extended transition period. Our financial statements may therefore not be comparable to those of companies that comply with such new or revised accounting standards. Upon issuance of new or revised accounting standards that apply to our financial statements, we will disclose the date on which adoption is required for non-emerging growth companies and the date on which we will adopt the recently issued accounting guidelines.

Our management’s discussion and analysis of financial condition and results of operations is based on our financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses. On an ongoing basis, we evaluate these estimates and judgments, including those described below. We base our estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances. These estimates and assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results and experiences may differ materially from these estimates.

There have been no material changes to the Company’s critical accounting policies and estimates as compared to the critical accounting policies and estimates described in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed with the SEC on March 27, 2014, which we believe are the most critical to aid you in fully understanding and evaluating our reported financial results and affect the more significant judgments and estimates that we use in the preparation of our financial statements.

## Liquidity and Capital Resources

The following table summarizes our liquidity and capital resources as of June 30, 2014 and 2013, respectively, and is intended to supplement the more detailed discussion that follows:

|                           | 2014 | June 30,<br>(in thousands) | 2013      |
|---------------------------|------|----------------------------|-----------|
| Cash and cash equivalents | \$   | 5,609                      | \$ 20,140 |
| Short-term investments    |      | 11,876                     | 246       |
| Working capital           |      | 17,344                     | 19,965    |

Our principal sources of liquidity are our cash and cash equivalents, short-term investments and the net proceeds from our initial public offering. Our payment terms for our customers range from 30 to 60 days. We consider the difference between the payment terms and payment receipts a result of transit time for invoice and payment processing and to date have not experienced any liquidity issues as a result of the payments extending past the specified terms. Cash and cash equivalents and short term investments consist primarily of cash on deposit with banks and investments in money market funds, corporate and municipal debt and U.S. government and U.S. government agency securities.

In March 2013, we received an approximately \$18.1 million cash infusion in connection with the completion of our IPO.

Under our business agreement with LinkedIn, LinkedIn made fixed quarterly payments to us in the amount of \$500,000 per quarter and paid us commissions for sales of our services in excess of certain thresholds. The agreement with LinkedIn terminated on March 29, 2014 and, as a result, LinkedIn is no longer a reseller of the Company's products or services and the Company will not receive the fixed quarterly payments of \$500,000 or have the potential to earn additional commission revenue from LinkedIn. Accordingly, the termination of our agreement with LinkedIn has had a material impact on revenue and operating cash flow in the near term. However, we will be permitted, as of March 30, 2014, to market and sell our products to any company, including those 1,000 companies on LinkedIn's restricted account list because as part of our termination arrangement with LinkedIn, the restricted account list will no longer apply. The Company has implemented a plan to actively engage with the 1,000 companies that were formerly restricted from us by agreement with LinkedIn. In addition we will also be marketing to customers that had purchased our products through contracts with LinkedIn with the intent of renewing those contracts directly as they expire over the coming 12 months. We feel that our existing salesforce has the capacity to service the additional potential customers we will target as a result of the termination of the LinkedIn agreement.

We currently anticipate that our available funds and cash flow from operations will be sufficient to meet our working capital requirements for the next twelve months.

|                                                      | Six Months Ended<br>June 30, |           |
|------------------------------------------------------|------------------------------|-----------|
|                                                      | 2014                         | 2013      |
|                                                      | (in thousands)               |           |
| Cash provided by (used in):                          |                              |           |
| Operating activities                                 | \$ (1,116)                   | \$ 867    |
| Investing activities                                 | (11,985)                     | (391)     |
| Financing activities                                 | (26)                         | 18,795    |
| Net (decrease) increase in cash and cash equivalents | \$ (13,127)                  | \$ 19,271 |

## Cash and Cash Equivalents

The Company considers cash and cash equivalents to include all short-term, highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less.

## Net Cash Provided by (Used in) Operating Activities

Net cash used in operating activities for the six months ended June 30, 2014 was \$1,116,000. We had a net loss of \$751,000 during the six months ended June 30, 2014, which was offset by non-cash depreciation and amortization of \$185,000, stock based compensation expense of \$26,000, a deferred tax benefit of \$513,000 and a decrease in the fair value of a warrant liability of \$14,000. Changes in working capital used \$49,000 of cash during the six months ended June 30, 2014.

The cash flow provided by operating activities during the six months ended June 30, 2013 was primarily attributable to changes in our assets and liabilities, mainly consisting of a decrease in accounts receivable of \$1,542,000. The decrease in accounts receivable was due to the collection of outstanding receivables. We had a net loss of \$615,000 during the six months ended June 30, 2013, which included non-cash interest and accretion added to our notes payable of \$155,000, non-cash depreciation and amortization of \$116,000, a non-cash deferred tax expense of \$105,000 and a decrease in the fair value of a warrant liability of \$311,000.

## Net Cash Used in Investing Activities

Net cash used in investing activities for the six months ended June 30, 2014 was \$11,985,000, consisting of \$14,976,000 from the purchase of short-term investments, \$98,000 invested in developed technology, \$12,000 in purchases of property and equipment, offset by \$3,100,000 of proceeds from the sale and maturities of short-term investments.

Net cash used in investing activities for the six months ended June 30, 2013 was \$391,000, primarily consisting of \$200,000 paid for the acquisition of technology, \$165,000 invested in developed technology and \$33,000 in purchases of property and equipment.

## Net Cash Provided by Financing Activities

The Company used \$26,000 to repurchase common stock during the six months ended June 30, 2014.

Net cash provided by financing activities was \$18,795,000 for the six months ended June 30, 2013. The cash provided by financing activities consisted of \$19,475,000 in net proceeds from our initial public offering less \$479,000 in initial public offering costs paid by the Company, offset by \$200,000 in distributions to members of the Company prior to our reorganization.

#### Off-Balance Sheet Arrangements

Since inception, we have not engaged in any off-balance sheet activities as defined in Regulation S-K Item 303(a)(4).

#### Recent Accounting Pronouncements

In July 2013, the FASB ASU, No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). ASU 2013-11 provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013, with an option for early adoption. The Company adopted ASU 2013-11 effective January 1, 2014 and the adoption did not have an impact on the condensed financial statements but may have an impact in future periods.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (ASU 201-09). ASU 201-09 provides guidance for revenue recognition and affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets and supersedes the revenue recognition requirements in Topic 605, “Revenue Recognition,” and most industry-specific guidance. The core principle of ASU 2014-09 is the recognition of revenue when a company transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, companies will need to use more judgment and make more estimates than under the current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for fiscal years beginning after December 15, 2016 and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). Early adoption is not permitted. The Company is currently evaluating the method and impact the adoption of ASU 2014-09 will have on the Company’s condensed financial statements and disclosures.

In June 2014, the FASB issued ASU No. 2014-12, “Compensation - Stock Compensation” (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period (“ASU 2014-12”). ASU 2014-12 affects entities that grant their employees share-based payments in which terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The amendments in ASU 2014-12 require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU 2014-12 is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the method and impact the adoption of ASU 2014-12 will have on the Company’s consolidated financial statements and disclosures.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

### ITEM 4. CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report, our management conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of June 30, 2014. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this report in ensuring that information required to be disclosed was recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and to provide reasonable assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### Limitations on the Effectiveness of Controls

The effectiveness of any system of internal control over financial reporting, including ours, is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting, including ours, no matter how well designed and operated, can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure you that such improvements will be sufficient to provide us with effective internal control over financial reporting.

#### Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting, as defined in Rule 13a-15(f) of the Exchange Act, that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

During 2013 and into the first half of 2014, we undertook certain improvements to remediate material weaknesses related to our internal control over financial reporting that were identified during the year ended December 31, 2013. Specifically, the Company implemented new policies to more fully segregate incompatible duties and enhance the overall internal control structure. Additional procedures were written supporting which functions employees with access to the general ledger system can access, which will provide additional internal control enhancements. In addition, we hired additional finance personnel to improve our segregation of incompatible duties within our accounting and financial reporting functions and also engaged a third party external financial reporting specialist with expertise in GAAP and SEC reporting regulations.

We anticipate that the actions described above and resulting improvements in controls will strengthen the Company's internal control over financial reporting and will, over time, address the related material weakness. However, because many of the controls in the company's system of internal controls rely extensively on manual review and approval, the successful operation of these controls may be required for several quarters prior to management being able to conclude that the material weakness has been remediated.

Specifically, we identified deficiencies in controls related to the segregation of incompatible duties and the application of complex accounting principles. While we believe we have other controls in place that are operating effectively and mitigate the risk of material misstatement, these control deficiencies could result in a misstatement of the presentation and disclosure of our financial statements that would result in a material misstatement in our annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that these control deficiencies constitute a material weakness in our internal control over financial reporting.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

None.

### ITEM 1A. RISK FACTORS

Not applicable.

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

Issuer Purchases of Equity Securities.

| Period                  | Total number<br>of<br>shares<br>purchased | Average price<br>paid<br>per share | Total number<br>of<br>shares<br>purchased as<br>part of publicly<br>announced<br>plan or<br>program | Approximate<br>dollar<br>value of shares<br>that<br>may yet be<br>purchased<br>under the plan or<br>program |
|-------------------------|-------------------------------------------|------------------------------------|-----------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|
| April 1- April 30, 2014 | -                                         | -                                  | -                                                                                                   | \$ 1,000,000                                                                                                |
| May 1 – May 31, 2014    | 6,182                                     | (1) \$ 4.14                        | 6,182                                                                                               | \$ 974,407                                                                                                  |
| June 1 – June 30, 2014  | -                                         | -                                  | 6,182                                                                                               | \$ 0 (2)                                                                                                    |

(1) All of these purchases were made in open-market transactions pursuant to the Company's share repurchase plan (the "Share Repurchase Plan") originally announced by the Company on April 29, 2013. Pursuant to the Share Repurchase Plan, the Company's board of directors authorized the Company to repurchase up to \$1 million of the Company's outstanding common stock over a six-month period beginning in April 2013, which period was subsequently extended by the Company's board of directors until May 30, 2014.

(2) The Share Repurchase Plan terminated on May 30, 2014, and no further shares of the Company's outstanding common stock may be repurchased thereunder.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Please see the exhibit index following the signature page of this Quarterly Report.

SIGNATURES

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

PROFESSIONAL DIVERSITY NETWORK, INC.

Date: August 14, 2014    By:    /s/ David Mecklenburger  
Name: David Mecklenburger  
Title: Chief Financial Officer  
(On behalf of the Registrant and as principal financial officer and  
principal  
accounting officer)

EXHIBIT INDEX

| Exhibit<br>Number | Description of Exhibit                                                                                                                                                                                                                                                                        |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1               | Agreement and Plan of Merger among Professional Diversity Network, Inc., NAPW Merger Sub, Inc., NAPW, Inc., and Matthew B. Proman, dated as of July 11, 2014, incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed with the SEC on July 14, 2014 |
| 31.1              | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d- 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                      |
| 31.2              | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d- 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                      |
| 32.1              | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                 |
| 101.INS           | XBRL Instance Document                                                                                                                                                                                                                                                                        |
| 101.SCH           | XBRL Taxonomy Extension Schema Document                                                                                                                                                                                                                                                       |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                                                                                                                                         |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document                                                                                                                                                                                                                                          |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                                                                                                                               |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                                                                        |