SPARK NETWORKS INC
Form 10-K
March 25, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009

OR

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

COMMISSION FILE NO. 001-32750

SPARK NETWORKS, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	**20-8901733**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
8383 Wilshire Boulevard, Suite 800, Beverly Hills, California	**90211**
(Address of principal executive offices)	**(Zip Code)**

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

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

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, par value $0.001 per share	**NYSE Amex**

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None.

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

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

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

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

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

The aggregate market value of the voting and non-voting common equity (which consists solely of shares of common stock) held by non-affiliates of the registrant as of June 30, 2009 was approximately $47,337,551 based on $2.30, the closing price of the registrant s common stock on the NYSE Amex on that date.

The registrant had 20,586,544 outstanding common stock, par value $0.001 per share, as of March 25, 2010.

Information required by Items 10, 11, 12, 13 and 14 of Part III are incorporated by reference from the Proxy Statement for the registrant s 2010 Annual Meeting of Stockholders. Except with respect to information specifically incorporated by reference in the Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

Table of Contents

SPARK NETWORKS, INC.

TABLE OF CONTENTS TO ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2009

Spark Networks and Spark Networks logos are trademarks and/or registered trademarks of Spark Networks Limited, the Company s wholly owned subsidiary.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

Table of Contents

and assumptions described in the Risk Factors section and elsewhere in this annual report on Form 10-K, regarding, among other matters:

- our ability to attract members to our Web sites, convert members into paying subscribers and retain our paying subscribers;
- the highly competitive nature of our business;
- our ability to keep pace with rapid technological change;
- the strength of our existing brands and our ability to maintain and enhance those brands;
- our ability to effectively manage our expenses;
- our dependence upon the telecommunications infrastructure and our networking hardware and software infrastructure;
- uncertainties relating to potential acquisitions of companies;
- the volatility of the price of our equity securities;
- the strain on our resources and management team of being a public company;
- the ability of our principal stockholders to exercise significant influence over our company; and
- other factors referenced in this annual report on Form 10-K and other reports.

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

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

ADDITIONAL INFORMATION

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

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

PART I

ITEM 1. BUSINESS

Unless the context otherwise requires, the terms Company, we, us, and our refer to Spark Networks, Inc., a Delaware corporation and its subsidiaries.

Our Business

We are a leading provider of online personals services in the United States and internationally. Our Web sites enable adults to meet online, participate in a community and form relationships. We provide this opportunity through many features on our Web sites, such as profiles, onsite email centers, real-time chat rooms, instant messaging services and offline singles events.

Currently, our key Web sites include JDate.com, Spark.com, BlackSingles.com and ChristianMingle.com. We operate several international Web sites and maintain operations in the United States and Israel. Information regarding the geographical source of our revenue and data on our four reportable segments can be found in Note 11 to our Consolidated Financial Statements included in this annual report. Membership on our sites is free and allows a registered user to post a personal profile and access our searchable database of member profiles and customer service. On most of our websites, the ability to initiate most communication with other members requires the payment of a monthly subscription fee, which represents our primary source of revenue. We offer discounted subscription rates for members who subscribe for periods longer than one month. Subscriptions primarily renew automatically for subsequent one-month periods until paying subscribers terminate them.

Prior to July 9, 2007, Spark Networks Limited (formerly known as Spark Networks plc) was a public limited company incorporated under the laws of England and Wales (Limited). Since the completion of our reorganization on July 9, 2007 through a shareholder vote and court process in the United Kingdom known as a Scheme of Arrangement , the common stock of Spark Networks, Inc., a Delaware corporation and Limited s parent entity, has been traded on the NYSE Amex (formerly the American Stock Exchange) and the Company has become Limited s successor reporting entity.

Our Industry

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

Our Competitive Strengths

Strength of the JDate Brand. We believe JDate, with its strong brand recognition, is a valuable asset. We believe the strength of the JDate brand will continue to allow us to market to and serve the Jewish community profitably. Because of the strength of the JDate brand, we are not required to spend as much on marketing JDate as we are on our other Web sites, or as much as others in the industry may spend on their personals Web sites.

Table of Contents

Affinity-Focused Communities. We believe singles are more likely to interact, find friends and form lasting relationships with like-minded individuals who share common values, beliefs, traditions and cultural upbringings. For this reason, the majority of our Web sites are targeted to specific religious, ethnic, geographic and special interest groups. We believe our targeted communities enjoy greater word-of-mouth recognition and consumer loyalty relative to general market communities.

Web Site Functionality. We continually evaluate the functionality of our Web sites to improve our members experience. Many of the features we offer, such as onsite emails, real-time chat rooms, instant messaging, E-cards and message boards increase the probability of communication between our members, which we believe increases the number and percentage of members who become or remain paying subscribers. We believe this functionality drives return visits to our Web sites and helps retain paying subscribers.

Customer Service Focus. Our multi-lingual call centers and email support team monitor our sites for fraudulent activity, assist members with billing questions, help members complete personal profiles and answer technical questions. We believe the quality of our customer service increases member satisfaction, which improves the number and percentage of members that become and remain paying subscribers.

Our Online Personals Services

Our online personals services offer single adults a convenient and secure setting for meeting other singles. Visitors to our Web sites are encouraged to become registered members and post profiles. Posting a profile is a process in which visitors are asked various questions about themselves, including information such as their tastes in food, hobbies and desired attributes of potential partners. Members may also post photos of themselves. Members can perform detailed searches of other profiles and save their preferences, and their profiles can be viewed by other members. In most cases, for a member to initiate email and instant message communication with others, that member must purchase a subscription. A subscription affords access to the paying subscribers on-site email, instant messaging systems, message boards and chat rooms, enabling such subscribers to communicate with other members and paying subscribers. Our subscription fees are charged on a monthly basis, with discounts for longer-term subscriptions.

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

Web Site	Target Audience
Jewish Networks	
JDate.com	Jewish singles
JDate.co.uk	Jewish singles
Cupid.co.il	Jewish singles (Hebrew speakers)
JDate.co.il	Jewish singles (Hebrew speakers)
JDate.fr	Jewish singles (French speakers)
General Market Networks	
Spark.com	Non-targeted
Kizmeet.com	Dating and matchmaking
Date.co.uk	UK singles
Other Affinity Networks	
AdventistSinglesConnection.com	Adventist singles
AsianSinglesConnection.com	Asian singles
BBWPersonalsPlus.com	Big beautiful women and admirers

Table of Contents

Web Site	Target Audience
BlackSingles.com	African-American singles
CanadianPersonals.net	Canadian singles
CatholicMingle.com	Catholic singles
ChristianMingle.com	Christian singles
DeafSinglesConnection.com	Deaf singles
GreekSinglesConnection.com	Greek singles
IndianMatrimonialNetwork.com	Indian singles
InterracialSingles.net	Interracial singles
ItalianSinglesConnection.com	Italian singles
LatinSinglesConnection.com	Latin singles
LDSMingle.com	Mormon singles
LDSSingles.com	Mormon singles
MilitarySinglesConnection.com	Military singles
SingleSeniorsMeet.com	Mature singles
SingleParentsMingle.com	Single parents
UKSinglesConnection.com	UK singles
Offline and Other Businesses	
HurryDate.com	Rapid dating and offline events
Facelink.com	Free dating search engine

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

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

Hot Lists and Favorites. Hot Lists enable members to see who is interested in them and to save those favorite members in whom they are interested. Lists include (1) who has viewed your profile, (2) your favorites and (3) who has emailed you. Members can group their favorites into customized folders and add their own notes, including details included in a member s profile.

Message Boards. Message Boards enable paying subscribers to communicate in a group environment with suggested topics for discussion.

Real-Time Chat Rooms. Paying subscribers can use our exclusive chat rooms to mix and mingle in real-time, building a sense of community through group discussions. Additional features enable users to add customized graphics such as emoticons to their conversations.

Ice Breakers. Members can send pre-packaged opening remarks, referred to on the Web sites as flirts and teases, to other members or paying subscribers.

Click! Our patented *Click!* feature connects members who think they would be compatible with each other. A member clicks yes, no or maybe in another member s profile. When two members click yes in each other s profiles, our patented feature sends an email to both of them alerting them of a possible match.

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

6

Table of Contents

Business Strategy

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

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

Integrated and targeted marketing. We believe targeting potential members with consistent and compelling marketing messages, delivered through a broad mix of marketing channels, will be effective in driving more traffic and a higher percentage of relationship-oriented singles to our Web sites. We intend to use a variety of channels to build our brands and increase our base of subscribers including online and offline advertising, customer relationship management tools, public relations, promotional alliances and special events.

Cross-promote. Our large base of members provides us with a significant amount of consumer data to evaluate cross-promotion opportunities for growth. We are able to analyze different groups of members by key metrics such as total potential subscribers and average revenue per paying subscriber and identify those targeted groups that may prefer a service dedicated to their particular affinity groups.

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

Improved member communications. We believe enhanced member communications is a key component to growing our business. We continue to focus on improving and enhancing our Web site functionality and features to encourage communications between members. Most of these communications require members to become paying subscribers. We will also continue to inform members of new features and functions to increase the number of visitors to our Web sites who become paying subscribers.

Improved search. We believe the more successful members are in finding matches in our database, the more likely they are to want to communicate with those members. To initiate email and instant message communication or participate in the chat rooms or message boards, members must become paying subscribers. We intend to continue to enhance the quality and relevance of our search results to provide fast, relevant suggestions.

Leveraging strong customer service. Each time a member or a potential member contacts our customer service center by email or phone, he or she represents a potential new paying subscriber. By training our customer service representatives on upselling opportunities, we believe they will continue to be successful in selling our services.

Extend into new affinity-focused markets. We constantly evaluate new opportunities to identify potential new affinity-focused markets into which we may expand either organically or through acquisition. Our large member base provides us with significant consumer data to evaluate opportunities for growth into such new markets and identify those target groups that may prefer a service dedicated to their particular affinity group.

Implement ad sales. We believe there is an opportunity for additional revenue from the sale of advertising on our Web sites. We expect advertisers will continue to seek highly targeted environments such as ours to complement their brands and reach niche consumers. We intend to remain selective about our choices for advertising partners so as not to adversely affect the quality of our user experience. In addition, advertisers have expressed an interest in our ability to provide them with an offline presence at our various parties and events around the country.

Sales and Marketing

We engage in a variety of marketing activities intended to drive consumer traffic to our Web sites and to allow us the opportunity to introduce our products and services to prospective members. Our marketing efforts are principally focused online, where we employ a combination of banner and other display advertising. We also rely on commercial search listings and direct email campaigns to attract potential members and paying subscribers, and use a network of online affiliates, through which we acquire traffic. None of these affiliates individually represents a material portion of our revenue. These affiliate arrangements are easily cancelable, often with only one day notice. Typically, we do not have exclusivity arrangements with our affiliates, and some of our affiliates may also be affiliates for our competitors.

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

Customer Service

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

Technology

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

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

Intellectual Property

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

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

Table of Contents

Competition

We operate in a highly competitive environment with minimal barriers to entry. We believe the primary competitive factors in creating a community on the Internet are functionality, brand recognition, critical mass of members, member affinity and loyalty, ease-of-use, quality of service and reliability. We compete with a number of large and small companies, including vertically integrated Internet portals and specialty-focused media companies that provide online and offline products and services to the markets we serve. Our principal online personals services competitors include Yahoo! Personals, Match.com, a wholly-owned subsidiary of InterActiveCorp, and eHarmony, all of which operate primarily in North America. In addition, we face competition from social networking Web sites such as MySpace and Facebook. There are numerous other companies offering online personals services, but are smaller than us in terms of paying subscribers and annual revenue generation.

Employees

As of December 31, 2009, we had 155 full-time equivalent employees. We are not subject to any collective bargaining agreements and we believe our relationship with our employees is good.

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business

Our growth rates may decline and our operating margins could deteriorate; our business may be adversely affected as a result of the economic downturn.

Our revenue has declined over the last few years. It is possible our operating margins will deteriorate if revenue growth does not exceed planned increases in expenditures for all aspects of our business in an increasingly competitive environment, including sales and marketing, general and administrative and technical operations expenses.

Our member and paying subscriber base is composed of individual consumers and in the event of a prolonged economic downturn in the United States or in our international markets in which spending by individual consumers drops significantly, our current and potential subscribers may be unable or unwilling to subscribe to our services and our business may be negatively affected. To the extent the overall economy continues to deteriorate, we may lose existing members and paying subscribers and fail to attract new members and paying subscribers. Average paying subscribers decreased 11.0% in 2009 compared to 2008. If our members and paying subscribers continue to decrease, then our revenue would decrease and our operations could be adversely affected.

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

Although we were profitable in 2008 and 2007, we have historically generated significant operating losses. As of December 31, 2009, we had an accumulated deficit of approximately $31.1 million. We had net income (loss) of approximately ($6.4), $4.8 and $9.0 million for the years ended December 31, 2009, 2008 and 2007, respectively. If our revenue does not grow at a substantially faster rate than our operating expenses, or if our operating expenses are higher than we anticipate, or if our revenue continues to decline but our operating expenses increase, we may not be profitable and we may incur additional losses, which could be significant.

Table of Contents

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

The capital and credit markets have been experiencing extreme volatility and disruption for more than twelve months. In 2009, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on availability of liquidity and credit capacity for certain issuers. Without sufficient liquidity, we may be forced to curtail certain operations and may be unable to operate our business as we deem appropriate. Disruptions, uncertainty or volatility in the capital and credit markets may also limit our access to capital required to operate our business. Such market conditions may limit our ability to replace, in a timely manner, maturing liabilities and access the capital necessary to operate and grow our business. As such, we may be forced to delay raising capital or bear an unattractive cost of capital which could decrease our profitability and significantly reduce our financial flexibility. Our results of operations, financial condition, cash flows and capital position could be materially adversely affected by disruptions in the financial markets.

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

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

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

Costs for us to acquire paying subscribers are dependent, in part, upon our ability to purchase advertising at a reasonable cost. Our advertising costs vary over time, depending upon a number of factors, many of which are beyond our control. Historically, we have used online advertising as the primary means of marketing our services.

Despite an economic downturn, costs of online advertising may continue to increase. If we are not able to reduce our other operating costs, increase our paying subscriber base or increase revenue per paying subscriber to offset these increases, our profitability will be adversely affected.

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

We secured a $25.0 million revolving credit facility, which could restrict our ability to use our operating cash flow for the growth of our business.

In February 2008, we entered into an agreement with Bank of America for a $30.0 million revolving credit facility, which was amended to $25.0 million on September 29, 2009, under which we had no outstanding borrowings as of December 31, 2009. If we are unable to pay our debts as they become due, we will be required to pursue one or more alternative strategies, such as refinancing or restructuring our indebtedness, selling additional debt or equity securities or selling assets. We may not be able to refinance our debt or issue additional debt or equity securities on favorable terms, if at all, and if we must sell our assets, it may negatively affect our ability to generate future revenue. If we are unable to meet our obligations as they become due or to comply with various financial covenants contained in the revolving credit facility, this could constitute an event of default.

Table of Contents

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

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

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

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

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

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

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

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

our brand strength in the marketplace relative to our competitors.

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

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

Evaluating the acquisition proposal by Great Hill Partners, considering other potential transactions and strategic alternatives and responding to related stockholder litigation may divert management s attention and other resources away from the Company s business.

On March 2, 2010, the Company received a proposal by Great Hill Partners III, LP (Great Hill) to purchase all of the outstanding shares of common stock of the Company not owned by Great Hill at a cash purchase price of $3.10 per share. A Special Committee of independent directors has retained a financial advisor and is reviewing and evaluating the proposal and any other potential transactions and strategic alternatives. The Special Committee will recommend to Spark Networks board of directors whether to approve or decline the proposal and any other potential transactions and strategic alternatives. On March 11, 2010, L.I.S.T. Incorporated initiated a class action lawsuit against the Company, Great Hill and each of the directors in the Court of Chancery of the State of Delaware and on March 24, 2010, Mike Shaffer initiated a class action lawsuit in the Superior Court of California, County of Los Angeles against the same defendants. Both lawsuits allege breach of fiduciary duty in connection with the proposal by Great Hill. Even if not meritorious, such litigation could be time-consuming and expensive and could result in the diversion of management s time and attention away from our day-to-day business. The Company believes that the allegations of the complaint are without merit and intends to vigorously contest the actions. However, there can be no assurances that the defendants will be successful in such defense. The Company and the directors could also be subject to further litigation related to the proposal or any other potential transaction. As the Company evaluates the proposal and any other potential transactions and addresses such litigation, the time and attention of management and the Company s directors will be less focused on our daily operations and businesses and may require us to incur significant expenses with financial and legal advisors. If the Company enters into an agreement, management s attention and other resources will be further diverted as the Company works toward completion of a transaction. The diversion of management attention and resources required could harm the Company s business, financial condition and operating results.

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

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

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

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

We operate in a market characterized by rapidly changing technologies, evolving industry standards, frequent new product and service announcements, enhancements and changing customer demands. Accordingly, our performance will depend on our ability to adapt to rapidly changing technologies and industry standards, and our ability to continually improve the speed, performance, features, ease of use and reliability of our services in response to both evolving demands of the marketplace and competitive service and product offerings. There have been occasions when we have not been as responsive as many of our competitors in adapting our services to changing industry standards and the needs of our members and paying subscribers. Our industry has been subject to constant innovation and competition. New features may be introduced by one competitor, and if they are perceived as attractive to users, they are often copied later by others. Over the last few years, such new feature introductions in the industry have included instant messaging, message boards, E-cards, personality profiles and mobile content delivery. Introducing new technologies into our systems involves numerous technical challenges, substantial amounts of capital and personnel resources and often takes many months to complete. We intend to continue to devote efforts and funds toward the development of additional technologies and services. For example, in 2008 and 2009 we introduced a number of new Web sites and features, and we anticipate the introduction of additional Web sites and features in 2010 and 2011. We may not be able to effectively integrate new technologies into our Web sites on a timely basis or at all, which may degrade the responsiveness and speed of our Web sites. Such technologies, even if integrated, may not function as expected.

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

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

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

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

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

Table of Contents

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

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

Furthermore, we rely on many different hardware systems and software applications, some of which have been developed internally. If these hardware systems or software applications fail, it would adversely affect our ability to provide our services. If we are unable to protect our data from loss or electronic or magnetic corruption, or if we receive a significant unexpected increase in usage and are not able to rapidly expand our transaction-processing systems and network infrastructure without any systems interruptions, it could seriously harm our business and reputation. We have experienced occasional systems interruptions in the past as a result of unexpected increases in usage, and we cannot assure you that we will not incur similar or more serious interruptions in the future. From time to time, our company and our Web sites have been subject to delays and interruptions due to software viruses, or variants thereof, such as internet worms.

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

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

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

Table of Contents

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

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

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

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports, effectively prevent fraud and operate as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We have, in the past, discovered and may, in the future, discover areas of our internal controls over financial reporting that need improvement. As a U.S. public company, we are subject to the reporting requirements of the Sarbanes-Oxley Act of 2002. We are required to annually assess and report on our internal controls over financial reporting. Beginning with the annual report for the fiscal year 2010, we are required to have our independent registered public accountant issue an opinion on the effectiveness of our internal controls. If we are unable to adequately maintain or improve our internal controls over financial reporting, we may report that our internal controls are ineffective and our external auditors will not be able to issue an unqualified opinion on the effectiveness of our internal controls. Ineffective internal controls over financial reporting could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our securities or could affect our ability to access the capital markets and which could result in regulatory proceedings against us by, among others, the U.S. Securities Exchange Commission.

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

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

- the need to implement or remediate controls, procedures and policies of acquired companies that lacked appropriate controls, procedures and policies prior to the acquisition;
- diversion of management time and focus from operating our business to acquisition integration challenges;
- cultural challenges associated with integrating employees from an acquired company into our organization;

retaining employees from the businesses we acquire; and

the need to integrate each company s accounting, management information, human resources and other administrative systems to permit effective management.

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

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

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

We believe that our Web sites, services, trademarks, patent and other proprietary technologies do not infringe upon the rights of third parties. However, there can be no assurance that our business activities do not and will not infringe upon the proprietary rights of others, or that other parties will not assert infringement claims against us. We are aware that other parties utilize the Spark name, or other marks that incorporate it, and those parties may have rights to such marks that are superior to ours. From time to time, we have been, and expect to continue to be, subject to claims in the ordinary course of business including claims of alleged infringement of the trademarks, service marks and other intellectual property rights of third parties by us. Although such claims have not resulted in any significant litigation or had a material adverse effect on our business to date, any such claims and resultant litigation might subject us to temporary injunctive restrictions on the use of our products, services or brand names and could result in significant liability for damages for intellectual property infringement, require us to enter into royalty agreements, or restrict us from using infringing software, services, trademarks, patents or technologies in the future. Even if not meritorious, such litigation could be time-consuming and expensive and could result in the diversion of management s time and attention away from our day-to-day business.

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

Table of Contents

We may face potential liability, loss of users and damage to our reputation for violation of our privacy policy or privacy laws and regulations.

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

In addition, our affiliates handle personally identifiable information pertaining to our members and paying subscribers. Both we and our affiliates are subject to laws and regulations related to Internet communications (including the CAN-SPAM Act of 2003), consumer protection, advertising, privacy, security and data protection. If we or our affiliates are found to be in violation of these laws and regulations, we may become subject to administrative fines or litigation, which could materially increase our expenses and cause the value of our securities to decline.

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

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

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

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

- the demand for, and acceptance of, our online personals services and enhancements to these services;
- the timing and amount of our subscription revenue;
- the introduction, development, timing, competitive pricing and market acceptance of our Web sites and services and those of our competitors;
- the magnitude and timing of marketing initiatives and capital expenditures relating to expansion of our operations;
- the cost and timing of online and offline advertising and other marketing efforts;

- the maintenance and development of relationships with portals, search engines, ISPs and other Web properties and other entities capable of attracting potential members and paying subscribers to our Web sites;

- technical difficulties, system failures, system security breaches, or downtime of the Internet, in general, or of our products and services, in particular;

- costs related to any acquisitions or dispositions of technologies or businesses;

- fluctuations in foreign exchange rates; and

- general economic conditions, as well as those specific to the Internet, online personals and related industries.

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

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

We currently anticipate that existing cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated needs for working capital, operating expenses and capital expenditures for at least the next 12 months. However, we may need to raise additional capital in the future to fund expansion, whether in new vertical affinity or geographic markets, develop newer or enhanced services, respond to competitive pressures or acquire complementary businesses, technologies or services. Such additional financing may not be available on terms acceptable to us or at all. To the extent that we raise additional capital by issuing equity securities, our stockholders may experience substantial dilution, and to the extent we engage in additional debt financing, if available, we may become subject to additional restrictive covenants that could limit our flexibility in conducting future business activities. If additional financing is not available or not available on acceptable terms, we may not be able to fund our expansion, promote our brands, take advantage of acquisition opportunities, develop or enhance services or respond to competitive pressures.

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

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

- challenges caused by distance, language and cultural differences;

- local competitors with substantially greater brand recognition, more users and more traffic than we have;

- our need to create and increase our brand recognition and improve our marketing efforts internationally and build strong relationships with local affiliates;

- longer payment cycles in some countries;

credit risk and higher levels of payment fraud in some countries;

different legal and regulatory restrictions among jurisdictions;

Table of Contents

- political, social and economic instability;
- potentially adverse tax consequences; and
- higher costs associated with doing business internationally.

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

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

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

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

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

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

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

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

Table of Contents

Risks Related to Our Industry

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

The majority of our revenue is generated by internet users that pay us a subscription fee. One of our key performance metrics focuses on the average number of paying subscribers in a given period. The number of monthly average paying subscribers is calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in the period. Internet users, in general, and users of online personals services specifically, freely navigate and use the services offered by a variety of Web sites. We cannot assure you that our monthly average subscriber numbers will remain at consistent levels, and they may decrease in the future, thus decreasing our revenue. In 2009, average paying subscribers decreased 11% and revenue also dropped 21% compared to 2008. If we do not constantly attract new paying subscribers at a faster rate than subscription terminations, our average paying subscribers will decrease and we will not be able to maintain or increase our current level of revenue.

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

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

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

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

The nature of online personals services is such that we cannot control the actions of our members and paying subscribers in their communication or physical actions. There is a possibility that one or more of our members or paying subscribers could be physically or emotionally harmed following interaction with another one of our members or paying subscribers. We warn our members and paying subscribers that we do not and cannot screen other members and paying subscribers and, given our lack of physical presence, we do not take any action to ensure personal safety on a meeting between members or paying subscribers arranged following contact initiated via our Web sites. If an unfortunate incident of this nature occurred in a meeting of two people following contact initiated on one of our Web sites or a Web site of one of our competitors, any resulting negative publicity could materially and adversely affect us or the online personals industry in general. Any such incident involving one of our Web sites could damage our reputation and our brands. This, in turn, could adversely affect our revenue and could cause the value of our common stock to decline. In addition, the affected members or paying subscribers could initiate legal action against us, which could cause us to incur significant expense, whether we were successful or not, and damage our reputation.

We face risks of litigation and regulatory actions if we are deemed a dating service as opposed to an online personals service.

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

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

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

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

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

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

Our services are dependent upon the use of the Internet and telephone and broadband communications to provide high-capacity data transmission without system downtime. There have been instances where regional and national telecommunications outages have caused us, and other Internet businesses, to experience systems interruptions. Any additional interruptions, delays or capacity problems experienced with telephone or broadband connections could adversely affect our ability to provide services to our customers. The temporary or permanent

Table of Contents

loss of all, or a portion, of the telecommunications system could cause disruption to our business activities and result in a loss of revenue. Additionally, the telecommunications industry is subject to regulatory control. Amendments to current regulations, which could affect our telecommunications providers, could disrupt or adversely affect the profitability of our business.

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

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

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

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

Legal uncertainties surrounding domestic and foreign government regulations could increase our costs of doing business, require us to revise our services, prevent us from delivering our services over the Internet or slow the growth of the Internet, any of which could increase our expenses, reduce our revenue or cause our revenue to grow at a slower rate than expected and materially adversely affect our business, financial condition and results of operations. Laws and regulations related to Internet communications, security, privacy, intellectual property rights, commerce, taxation, entertainment, recruiting and advertising are becoming more prevalent, and new laws and regulations are under consideration by the United States Congress, state legislatures and foreign governments. For example, in recent years, legislation related to the use of background checks for users of online personals services was proposed in Ohio, Texas, California, Michigan, New Jersey, Florida and Virginia. The New Jersey legislature enacted such a law in 2008 and other state legislatures may still be considering the implementation of such legislation. The interpretation of the New Jersey statute as well as the enactment of any of these proposed laws could require us to alter our service offerings and could negatively impact our performance by making it more difficult and costly to obtain new subscribers and may also subject us to additional liability for failure to properly screen our subscribers.

Table of Contents

Furthermore, in part as a result of current economic conditions, some states have begun to, and others may in the future, impose state taxes on services provided through the Internet, such as online personals, which will increase the cost of our services and could adversely affect our business. Any legislation and regulations enacted or newly enforced or restrictions arising from current or future government investigations or policy could dampen the growth in use of the Internet, generally, decrease the profitability of Internet related businesses and diminish the acceptance of the Internet as a communications, commercial, entertainment, recruiting and advertising medium. In addition to new laws and regulations being adopted, existing laws that are not currently being applied to the Internet may subsequently be applied to it, in some cases with a retroactive effect or penalty, and, in several jurisdictions, legislatures are considering laws and regulations that would apply to the online personals industry in particular. Many areas of law affecting the Internet and online personals remain unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws such as those governing consumer protection, intellectual property, libel and taxation apply to the Internet or to our services. In the normal course of our business, we handle personally identifiable information pertaining to our members and paying subscribers residing in the United States and other countries. In recent years, many of these countries have adopted privacy, security and data protection laws and regulations intended to prevent improper uses and disclosures of personally identifiable information. In addition, some jurisdictions impose database registration requirements for which significant monetary and other penalties may be imposed for noncompliance. These laws may impose costly administrative requirements, limit our handling of information, and subject us to increased government oversight and financial liabilities. Privacy laws and regulations in the United States and foreign countries are subject to change and may be inconsistent, and additional requirements may be imposed at any time. These laws and regulations, the costs of complying with them, administrative fines for noncompliance and the possible need to adopt different compliance measures in different jurisdictions could materially increase our expenses and cause the value of our securities to decline.

Risks Related to Owning Our Securities

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

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

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

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

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

As of March 25, 2010, Great Hill Investors, LLC, North Run Advisors, LLC, Osmium Partners, LLC and Moab Capital Partners, LLC and their respective affiliates beneficially owned approximately, in the aggregate, 62.3% of our outstanding common stock. Great Hill Investors, LLC and its affiliates (Great Hill) became our largest stockholder on December 1, 2005 when it purchased an aggregate of 6,000,000 ordinary shares in four privately negotiated transactions and it subsequently acquired an additional 3,085,000 shares. Great Hill and its affiliates held an aggregate of 9,085,000 shares of common stock as of March 25, 2010. These stockholders possess significant influence over our company. Such ownership and control may have the effect of delaying or preventing a change in control of our company, impeding a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company. Furthermore, such ownership may have the effect of control over substantially all matters requiring stockholder approval, including the election of directors. Other than the arrangement to elect a director at the selection of Great Hill which affects some of these stockholders, as discussed below, we do not expect that these stockholders will vote together as a group. It should be noted that Great Hill Investors, LLC ownership information is based on a Schedule 13D/A filed with the SEC on March 2, 2010, North Run Advisors, LLC ownership information is based on a Schedule 13G filed with the SEC on February 17, 2009, Osmium Partners, LLC ownership information is based on a Schedule 13D filed with the SEC on March 9, 2010 and Moab Capital Partners, LLC ownership information is based on a Schedule 13G/A filed with the SEC on February 16, 2010.

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

As of March 25, 2010, Great Hill beneficially owned 9,085,000 shares of our common stock, or approximately 44.1% of our outstanding common stock, and has voting control of an aggregate of approximately 48.7% of our securities to elect a director of our company subject to the terms and conditions of the share purchase agreements entered into on December 1, 2005 with certain selling stockholders (collectively, the Selling Stockholders). Pursuant to the terms of the share purchase agreements with each of the Selling Stockholders, for so long as Great Hill collectively owns at least 10% or 5%, depending on the Selling Stockholder, each Selling Stockholder agreed that:

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

- if at any time Great Hill notifies a Selling Stockholder of its desire and intention to remove or replace a Great Hill Director or to fill a vacancy caused by the resignation of a Great Hill Director, such Selling Stockholder agreed to cooperate in causing the requested removal and/or replacement by voting in the appropriate manner.

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

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

We have entered into a standstill agreement pursuant to which Great Hill and its affiliates may be permitted to acquire additional voting securities of our company in the future and may initiate and participate in any tender, takeover or exchange offer, other business combination or other transaction, such as taking our company private, any of which may be to the detriment of our stockholders.

On December 1, 2005, we and Great Hill Equity Partners II, which is one of the affiliates of Great Hill, entered into a Standstill Agreement with a term of five years, unless terminated earlier by the agreement of the parties.

Pursuant to the Standstill Agreement, Great Hill Equity Partners II agreed that it would not, other than through bona fide all cash offers made in accordance with the terms of the Standstill Agreement to all of the Company s stockholders or stock repurchases or other actions initiated by the Company, acquire or seek to acquire beneficial ownership of any of our voting securities (or rights to acquire any class of our securities or any subsidiary thereof) or participate in any tender, takeover or exchange offer or other business combination, or any recapitalization, restructuring, dissolution or other extraordinary transaction if (1) prior to giving effect thereto, the Great Hill Group beneficially owns less than 60% of Total Voting Power and (2) after giving effect, the Great Hill Group would beneficially own more than 29.9% of Total Voting Power.

As such, Great Hill may, in accordance with the terms of the Standstill Agreement, participate in and initiate any tender, takeover or exchange offer, other business combination or other transaction, such as taking our company private, any of which may be to the detriment of our stockholders.

On March 2, 2010, the Company granted a partial waiver of the Standstill Agreement to the extent necessary to allow the special committee of the board of directors to receive, discuss and negotiate a proposal by Great Hill to purchase all of the outstanding shares of common stock of the Company not owned by Great Hill, at a cash purchase price of $3.10 per share. The waiver will automatically (but not retroactively) terminate if the Company, at the direction of the board of directors or the special committee, decides to discontinue discussions with Great Hill.

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

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

Table of Contents

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

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

Although pursuant to a stockholder resolution passed by the Company s stockholders in 2009, the Company will take the steps necessary in connection with the next annual meeting to reorganize the board of directors into one class of directors elected annually, our certificate of incorporation currently provides that, subject to the rights of any series of preferred stock to elect directors, the board of directors is to be divided into three classes of directors with each class elected to serve for a term of three years. As a result of a classified board of directors, not all members of the board are elected at one time, which makes changes in the composition of the board of directors more difficult, and thus a potential change in control of a corporation a lengthier and more difficult process. In addition, there are no cumulative voting rights. Our certificate of incorporation and bylaws also contain provisions that could have the effect of discouraging potential acquisition proposals or making a tender offer or delaying or preventing a change in control, including changes a stockholder might consider favorable. In particular, the certificate of incorporation and bylaws, as applicable, among other things:

- provide the board of directors with the ability to alter the bylaws without stockholder approval;

- provide for an advance notice procedure with regard to the nomination of candidates for election as directors and with regard to business to be brought before a meeting of stockholders; and

- provide that vacancies on the board of directors may be filled by a majority of directors in office, although less than a quorum.

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

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

Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

We do not own any real property that is materially important to our business. Our headquarters is located in Beverly Hills, California, where we occupy approximately 16,000 square feet of office space, housing our technology department and most of our corporate and administrative personnel. Our current lease for this space runs from August 1, 2008 through July 31, 2011. It has a monthly base rent starting at $59,911 for the first year, increasing to $62,373 for the second year and $64,835 for the final year of the lease. We also leased office space in Utah, New York and Israel and datacenter space in California and Utah in 2009. We believe that our facilities are adequate for our current needs and suitable additional or substitute space will be available in the future to replace our existing facilities, if necessary, or accommodate expansion of our operations.

ITEM 3. LEGAL PROCEEDINGS

Spark Network Services, Inc. v. Match.com, LP, eHarmony.com, Inc., Various, Inc., True Beginnings, LLC, Perfect Match LLC, Plentyoffish Media, Inc. and Spark Networks, Inc.

On January 30, 2007, Spark Network Services, Inc. initiated an action in the United States District Court for the Northern District of Illinois, Eastern Division. On December 4, 2007, Plaintiff, Spark Networks Services, filed an Amended Complaint, adding Spark Networks, Inc. as a defendant. Spark Networks Services asserted in the Amended Complaint that Spark Networks, Inc. infringed certain claims of U.S. Patent No. 6,272,467 by allegedly using the 467 patent s claimed methods for automated two way matching of selected traits and preferences for determining the users compatibility. Spark Networks, Inc. filed an Answer in which it denied infringing the 467 patent and asserted that the 467 patent is invalid. On January 7, 2008, defendants Match.com and eHarmony.com filed a motion asking the Court to stay the litigation pending the outcome of a reexamination proceeding that had been requested in the U.S. Patent Office with respect to the 467 patent. The reexamination request alleges that the asserted (and other) claims of the 467 patent are invalid based on certain prior art. On January 28, 2008, the reexamination request was granted by the Patent Office. The litigation was then stayed on February 21, 2008. The parties settled the case on March 16, 2010 and on March 22, 2010, a stipulated proposed order to dismiss the case was filed with the court.

ISYSTEMS v. Spark Networks, Inc. et al.

On July 11, 2008, ISYSTEMS initiated a lawsuit against Spark Networks, Inc., Spark Networks Limited and other parties in the United States District Court, Northern District of Texas, Dallas Division. The lawsuit was filed in response to an arbitration award ordering the transfer of the domain name, JDATE.NET, to Spark Networks Limited from ISYSTEMS. Spark Networks was apprised of the lawsuit after ISYSTEMS unsuccessfully attempted to utilize the filing of the lawsuit to prevent the domain transfer to Spark Networks Limited. On December 1, 2008, Spark Networks filed a Motion to Dismiss the Complaint, or, alternatively, for Summary Judgment. On June 10, 2009, the Court granted our motion and dismissed the case with prejudice. On June 22, 2009, ISYSTEMS filed a motion to vacate the order dismissing the action and requesting leave to amend its complaint. On October 26, 2009, the Court granted ISYSTEMS motion. ISYSTEMS filed its Amended Complaint on November 25, 2009. On January 19, 2010, Spark Networks filed a Motion to Dismiss the Amended Complaint, or Alternatively, for Summary Judgment. A trial date has been tentatively set for January 2011.

Ness Interactive v. Spark Networks Limited

On January 22, 2010, Spark Networks Limited was served with a complaint from Ness Interactive alleging that Spark Networks engaged in unfair competition by bidding on certain online advertising keywords in France. An initial hearing has been scheduled for April 16, 2010.

Table of Contents

L.I.S.T. Incorporated v. Spark Networks, Inc. et al

On March 11, 2010, L.I.S.T. Incorporated initiated a class action lawsuit against Spark Networks, Inc., Adam S. Berger, Jonathan B. Bulkeley, Benjamin Derhy, Thomas G. Stockham, Michael A. Kumin, Great Hill Equity Partners III, LP and Great Hill Partners, LLC in the Court of Chancery of the State of Delaware, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own.

Mike Shaffer v. Spark Networks, Inc. et al

On March 24, 2010, Mike Shaffer initiated a class action lawsuit against Adam Berger, Michael Kumin, Jonathan Bulkeley, Benjamin Derhy, Thomas G. Stockham, Spark Networks, Inc., Great Hill Partners, LLC and Great Hill Equity Partners III, LP in the Superior Court of California, County of Los Angeles, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own.

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

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

ITEM 4. RESERVED

Table of Contents

PART II.

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

Market Information

Spark Networks, Inc s. common stock is traded on the NYSE Amex (formerly the American Stock Exchange) under the trading symbol LOV. The following table summarizes the high and low sales prices of our common stock as reported by the NYSE Amex or American Stock Exchange.

	High	Low
Year ended December 31, 2008		
First Quarter	$ 5.75	$ 3.99
Second Quarter	$ 4.50	$ 4.00
Third Quarter	$ 4.41	$ 3.90
Fourth Quarter	$ 3.87	$ 2.55

	High	Low
Year ended December 31, 2009		
First Quarter	$ 2.60	$ 2.21
Second Quarter	$ 2.93	$ 2.19
Third Quarter	$ 2.78	$ 2.10
Fourth Quarter	$ 3.04	$ 2.23

Holders

As of March 24, 2010, there were 62 holders of record of our common stock.

Dividends

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

Securities Authorized for Issuance Under Equity Compensation Plans

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

Unregistered Sales of Equity Securities

During the year ended December 31, 2009, we did not issue unregistered securities.

Purchases of Equity Securities

We did not purchase any shares in the year ended December 31, 2009.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable for a smaller reporting company

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.
The following discussion of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and the related notes that are included in this report.

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

General

Prior to July 9, 2007, Spark Networks plc (now known as Spark Networks Limited) was a public limited company incorporated under the laws of England and Wales (Limited). Since the completion of our reorganization on July 9, 2007 through the Scheme of Arrangement, the common stock of Spark Networks, Inc., a Delaware corporation and Limited s parent entity, has been traded on the NYSE Amex (formerly the American Stock Exchange) and the Company has become Limited s successor reporting entity. The Company and its consolidated subsidiaries provide online personals services in the United States and internationally, whereby adults are able to post information about themselves (profiles) on the Company s Web sites and search and contact other individuals who have posted profiles.

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

For the year ended December 31, 2009, we had 166,267 average paying subscribers, representing a decrease of 11% from the year ended December 31, 2008. Paying subscribers are defined as individuals who have paid a monthly fee for access to communication and web site features beyond those provided to our non-paying members. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in such period. Our key Web sites include JDate.com, which primarily targets Jewish singles in the United States, AmericanSingles (which was rebranded as Spark.com in December 2009), which targets singles in the United States, BlackSingles.com, which primarily targets black singles in the United States, and ChristianMingle.com, which primarily targets Christian singles in the United States. Our subscription fees have traditionally been charged on a monthly basis, with discounts for longer-term subscriptions.

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

Table of Contents

During the last three years, in addition to a number of small acquisitions, we made the following larger acquisitions:

In December 2008, we acquired certain digital media assets and liabilities of a company for total consideration of $1.1 million. Of the $1.1 million consideration, $50,000 was assigned to indefinite life domain names and the remaining amount was assigned to developed software, to be amortized over 5 years. These acquired assets expanded and enhanced our current product offerings.

On February 1, 2007, we purchased the assets of HurryDate, a leading online personals and singles events company. Of the $4.3 million cash consideration paid, $490,000 was assigned to member databases and is being amortized over three years, $50,000 was assigned to subscriber databases and was amortized over five months, $800,000 was assigned to developed software which is being amortized over five years, $360,000 was assigned to domain names which are not subject to amortization and the remainder was assigned to goodwill. In 2008 and 2009, the Company impaired the goodwill balances associated with HurryDate.

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

Critical Accounting Policies, Estimates and Assumptions

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

Management has discussed the development and selection of our critical accounting policies, estimates and assumptions with our board of directors and the board has reviewed these disclosures.

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

Revenue Recognition and Deferred Revenue

Substantially all of our revenue is derived from subscription fees. Revenue is presented net of credits and credit card chargebacks. We recognize revenue in accordance with accounting principles generally accepted in the United States. Revenue recognition occurs ratably over the subscription period, beginning when there is persuasive evidence of an arrangement, delivery has occurred (access has been granted), the fees are fixed or determinable, and collection is reasonably assured. Paying subscribers primarily pay in advance using a credit card and, subject to certain conditions identified in our terms and conditions, all purchases are final and

Table of Contents

nonrefundable. Subscription fees collected in advance are deferred and recognized as revenue, using the straight-line method, over the term of the subscription. We reserve for potential credit card chargebacks based on our historical chargeback experience.

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

Cost of Revenue

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. We incur substantial expenses related to our advertising in order to generate traffic to our Web sites. These advertising costs are primarily online advertising, including affiliate and co-brand arrangements, and are directly attributable to the revenue we receive from our subscribers. We have entered into numerous affiliate arrangements, under which our affiliates advertise or promote our Web site, and earn a fee whenever visitors click through the affiliate s advertisement to one of our Web sites and register or subscribe, on our Web site. We do not typically have any exclusivity arrangements with our affiliates, and some of our affiliates may also be affiliates for our competitors. Under our co-branded arrangements, our co-brand partners may operate their own separate Web sites where visitors can register and subscribe to our Web sites. Affiliate deals, co-brand deals and online advertising arrangements may fall in the categories of CPS, CPA, CPC, or CPM, as discussed below.

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

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

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

Prepaid Advertising Expenses

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

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

We test goodwill and indefinite-lived intangible assets for impairment at least annually, or more frequently when circumstances indicate that the carrying value may not be recoverable and test property, plant and equipment and

Table of Contents

other intangible assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Factors we consider important and which could trigger an impairment review include the following:

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

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

In 2009, we performed our annual impairment analysis and determined the fair value of each reporting unit and compared it to the carrying amount of the reporting unit. The fair value of the Jewish Networks reporting unit was significantly higher than the carrying value as of December 31, 2009 and thus did not require any impairment. Based upon several valuation assumptions, including lower expected performance and lower industry multiples, the analysis concluded that the carrying value of the Other Affinity Networks business was higher than its estimated fair value. As a result, the Company performed the second step under the guidance to assess the fair value of the assets and liabilities of Other Affinity Networks. The analysis resulted in impairment to goodwill and domain names of $9.3 million and $1.3 million, respectively. In 2009, we paid the final $1.4 million in earn-out payments for the HurryDate business. The earn-out payments were recorded as impairment expense based on business performance. There were no additional impairments as a result of the assessment. As of December 31, 2009, Jewish Networks and Other Affinity Networks carried goodwill balances of $6.8 million and $1.9 million, respectively.

Additionally, in 2009, we impaired approximately $110,000 of capitalized software development costs when we determined that a web-based product failed to perform to Company standards.

In 2008, the Company performed its annual valuation and concluded that a sustained decline in HurryDate s speed dating business had reduced projected cash flows below the carrying amount of the reporting unit. As such, the Company impaired the entire amount of HurryDate s goodwill of $1.2 million. No other impairment charges resulted from this evaluation since the fair value of each reporting unit exceeded the carrying amount.

Also in 2008 we were capitalizing costs related to a Web site that we planned to develop. We decided that we would not continue the development in the same manner and as such we impaired the $119,000, which had been capitalized up to that point.

Accounting for Business Combinations

We have acquired the stock or specific assets of a number of companies from 1999 through 2009 some of which were considered to be business acquisitions. Under the purchase method of accounting, the cost are allocated to the underlying net assets, based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill.

Table of Contents

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

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

The value of our intangible and other long-lived assets, including goodwill, is exposed to future adverse changes if we experience declines in operating results or experience significant negative industry or economic trends or if future performance is below historical trends. We review intangible assets and goodwill for impairment at least annually or more frequently when circumstances indicate that the carrying value may not be recoverable using the guidance of applicable accounting literature. We continually review the events and circumstances related to our financial performance and economic environment for factors that would provide evidence of the impairment of goodwill, identifiable intangibles and other long-lived assets.

Legal Contingencies

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

Accounting for Income Taxes

We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and tax bases of the assets and liabilities. In the fourth quarter of 2007, we analyzed our past performance as well as other factors and concluded that all of the net operating losses incurred by the Company would more likely than not be used to offset future income and the valuation allowance against our deferred tax assets was released.

At December 31, 2009, we had gross net operating loss (NOL) carry-forwards for income tax purposes of approximately $16.0 million and $36.4 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2024 for federal purposes and 2016 for state purposes. Under section 382 of the Internal Revenue Code, the utilization of the net operating loss carry-forwards can be limited based on changes in the percentage ownership of the Company.

Of the NOLs available, approximately $1.4 million for federal purposes are attributable to losses incurred by an acquired subsidiary. Such losses are subject to other restrictions on usage including the requirement that they are only available to offset future income of the subsidiary. In addition, the available NOLs do not include any amounts generated by the acquired subsidiary prior to the acquisition date due to substantial uncertainty regarding the Company s ability to realize the benefit in the future.

As a result of the adoption of the share-based payment guidance, the Company will recognize excess tax benefits associated with the exercise of stock options directly to stockholders equity only when realized. Accordingly, deferred tax assets are not recognized for NOL carry forwards resulting from excess tax benefits. As of December 31, 2009, deferred tax assets do not include approximately $6.9 million of these excess tax benefits from employee stock option exercises that are a component of the Company s NOL carry forwards. Additional paid in capital will be increased up to an additional $6.9 million if and when such excess tax benefits are realized. During 2009, approximately $2.2 million related to net excess tax benefits were realized.

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

Stock Based Compensation

We adopted the Share-Based Payment guidance in 2005 using the modified prospective approach and accordingly periods prior to 2005 have not been restated to reflect the impact of the guidance.

Prior to our adoption of the guidance, we did not record tax benefits of deductions resulting from the exercise of stock options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2009 and 2008, we recognized cash inflows of approximately $3.2 million and $3.0 million, respectively, related to tax provision or benefit from stock-based compensation.

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

Our computation of expected volatility is based on a combination of historical and market-based implied volatility. The volatility rate was derived by examining historical stock price behavior and assessing management s expectations of stock price behavior during the term of the option. The term of the options was derived based on the simplified method calculation. We are using the simplified method calculation, which is derived by averaging the vesting term with the contractual terms due to a change in the stock exchange on which the Company s stock was traded. We do not believe exercise behavior and expected term are consistent across the different stock exchanges.

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

Table of Contents

Segment Reporting

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for making operating decisions and assessing performance. The Company s financial reporting includes detailed data on four separate operating segments which were principally determined based on similarity of economic characteristics. During the third quarter 2007, we changed our financial reporting to include data on four newly-defined operating segments: Jewish Networks, which consists of JDate.com, JDate.co.il, Cupid.co.il and their respective co-branded and private label Web sites; General Market Networks, which consists of AmericanSingles.com and Date.ca, which were both rebranded as Spark.com in December of 2009 and Date.co.uk which was rebranded as Spark.com in February 2010, and their respective co-branded and private label Web sites; Other Affinity Networks, which consists of the Company s Provo, Utah-based properties which are primarily made up of sites targeted towards various religious, ethnic, geographic and special interest groups; and Offline and Other Businesses, which consists of revenue generated from offline activities, HurryDate events and subscriptions, and other Web sites and businesses. The Company believes the segments will provide investors with a more accurate picture of the performance of the business.

Results of Operations

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

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

	2009	2008	2007
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenue	33.5	32.7	38.6
Sales and marketing	7.7	7.4	5.6
Customer service	4.0	4.0	4.6
Technical operations	3.3	3.3	2.9
Development	8.6	7.8	6.5
General and administrative	21.9	23.2	28.6
Depreciation	1.9	1.5	2.6
Amortization of intangible assets other than goodwill	1.5	1.4	2.1
Impairment of goodwill, long-lived assets and other assets	26.4	2.4	2.9
Total costs and expenses	108.8	83.7	94.4
Operating income (loss)	(8.8)	16.3	5.6
Interest and other (income) expenses, net	(2.4)	0.2	(1.4)
Income (loss) before income taxes	(6.4)	16.1	7.0
Provision (benefit) for income taxes	7.7	7.7	(6.8)
Net income (loss)	(14.1)%	8.4%	13.8%

Table of Contents

The following table describes certain selected information and Adjusted EBITDA [1] for the years ended December 31,

	2009	2008	2007
Net income (loss)	$ (6,404)	$ 4,788	$ 8,978
Interest expense	378	152	(751)
Income taxes	3,479	4,425	(4,434)
Depreciation	873	867	1,684
Impairments	11,999	1,354	1,894
Amortization of intangible assets	663	787	1,356
Non-cash currency translation adjustments	(30)	(41)	(204)
Stock-based compensation	1,041	3,868	5,321
Scheme of arrangement			1,897
Non-repetitive property possession	(1,507)		
Adjusted EBITDA(1)	**$ 10,492**	**$ 16,200**	**$ 15,741**

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

Adjusted EBITDA does not reflect the cash capital expenditures during the measurement period

Adjusted EBITDA does not reflect any changes in working capital requirements during the measurement period

Adjusted EBITDA does not reflect the cash tax payments during the measurement period

Adjusted EBITDA may be calculated differently by other companies in our industry, thus limiting its value as a comparative measure Adjusted EBITDA should not be construed as a substitute for net income (loss) (as determined in accordance with GAAP) for the purpose of analyzing our operating performance or financial position, as Adjusted EBITDA is not defined by GAAP.

Adjusted EBITDA is defined as earnings before interest, taxes, depreciation, amortization, stock-based compensation, impairment of long-lived assets, non-cash currency translation adjustments for inter-company loans and Scheme of Arrangement costs and one- time items that have not occurred in the past two years and are not expected to recur in the next two years.

Key Metric Average Paying Subscribers

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

37

Unaudited selected statistical information regarding Average Paying Subscribers for our operating segments is shown in the table below. Prior period amounts have been reclassified to conform to current period presentation.

	Year Ended December 31,		
	2009	2008	2007
Average Paying Subscribers			
Jewish Networks	86,030	90,806	94,246
Other Affinity Networks	66,078	63,859	61,398
General Market Networks	13,219	30,486	56,071
Offline and Other Businesses	940	1,806	1,783
Total Average Paying Subscribers	**166,267**	**186,957**	**213,498**

Average paying subscribers for the Jewish Networks segment decreased 5% to 86,030 for the year ended December 31, 2009 compared to 90,806 in 2008. We believe the decrease in average paying subscribers is due in part to softness in the global economy and potentially in reaction to our April 2007 rate increase on certain sites within the Jewish Networks segment. Average paying subscribers for the General Market Networks segment decreased 57% to 13,219 for the year ended December 31, 2009 compared to 30,486 in 2008. This decrease can be primarily attributed to management s decision to improve marketing efficiency within this segment and the related reduction in inefficient marketing expenses. Average paying subscribers for the Other Affinity Networks segment increased 3% to 66,078 for the year ended December 31, 2009 compared to 63,859 in 2008, reflecting increased marketing expenses and a shift in brand investment within this segment. Average paying subscribers for the Offline and Other Businesses segment decreased 48% to 940 for the year ended December 31, 2009 compared to 1,806 in 2008, primarily due to the operating results of HurryDate.

Average paying subscribers for the Jewish Networks segment decreased 4% to 90,806 for the year ended December 31, 2008 compared to 94,246 in 2007. We believe the decrease in average paying subscribers is due in part to softness in the global economy and potentially in reaction to our April 2007 rate increase on certain sites within the Jewish Networks segment. Average paying subscribers for the General Market Networks segment decreased 46% to 30,486 for the year ended December 31, 2008 compared to 56,071 in 2007. This decrease can be primarily attributed to management s decision to improve marketing efficiency within this segment and the related reduction in inefficient marketing expenses. Average paying subscribers for the Other Affinity Networks segment increased 4% to 63,859 for the year ended December 31, 2008 compared to 61,398 in 2007, reflecting increased marketing expenses and greater brand recognition. Average paying subscribers for the Offline and Other Businesses segment increased to 1,806 for the year ended December 31, 2008 compared to 1,783 in 2007, primarily due to the operating results of HurryDate.

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

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Revenue

Substantially all of our revenue is derived from subscription fees. Approximately 5% and 6% of our revenue for the years ended December 31, 2009 and 2008, respectively, is generated through offline social and travel events, and advertising revenue. Revenue is presented net of credits and credit card chargebacks. In the case of subscription revenue, recognition occurs ratably over the subscription period and typically represents one month, three month, five month, six month and twelve month terms. We offer discounts to subscribers of plans covering more than one month. Most of our subscription plans have an automatic renewal feature upon expiration of the then current plan.

Revenue for the year ended December 31, 2009 decreased 20.7% to $45.4 million from $57.3 million in 2008. The revenue decrease can be primarily attributed to a 65.3% decrease in General Market Networks revenue and a 14.5% decrease in Jewish Networks revenue.

Revenue for the Jewish Networks segment decreased 14.5% to $28.8 million for the year ended December 31, 2009, compared to $33.7 million in 2008. The lower Jewish Networks revenue reflects a 10.2% decrease in average revenue per user (ARPU) and a 5.3% decrease in average paying subscribers. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related price points as we focused on growing our network. Revenue for the General Market Networks segment decreased 65.3% to $2.7 million for the year ended December 31, 2009, compared to $7.8 million in 2008. The decrease in General Market Networks revenue is due to a 56.6% decrease in average paying subscribers, reflecting management s decision to eliminate inefficient online marketing expenses. Revenue for our Other Affinity Networks segment decreased 7.1% to $12.8 million for the year ended December 31, 2009, compared to $13.7 million in 2008. The lower Other Affinity Networks revenue reflects a 9.8% decrease in ARPU, offset by a 3.5% increase in average paying subscribers. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related price points as we shifted our focus to a select group of brands within this segment. Revenue of our Offline and Other Businesses segment decreased 46.3% to $1.1 million for the year ended December 31, 2009 compared to $2.0 million in 2008. The decrease in revenue is attributable to lower revenue from our speed dating events and fewer travel offerings versus 2008.

Costs and Expenses

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses increased 3.1% to $49.4 million for the year ended December 31, 2009, compared to $47.9 million in 2008. Excluding asset impairment charges, operating expenses decreased 19.7% to $37.4 million in 2009 compared to $46.6 million in 2008. Lower cost of revenue and general and administrative expense accounted for the majority of the decrease.

Cost of Revenue. Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue decreased 18.7% to $15.2 million for the year ended December 31, 2009, compared to $18.7 million in 2008. Direct marketing expenses decreased 19.6% to $12.1 million for the year ended December 31, 2009, compared to $15.0 million in 2008. The lower direct marketing expenses reflect a $2.8 million reduction in General Market Networks marketing investment, reflecting management s decision to eliminate inefficient online marketing partners. Direct marketing expenses for the Jewish Networks segment decreased 6.9% to $2.3 million for the year ended December 31, 2009, compared to $2.5 million in 2008. The decrease in marketing expense reflects a shift to more efficient online marketing programs from less efficient offline marketing channels. Direct marketing expenses for the General Market Networks segment decreased 80.7% to $676,000 for the year ended December 31, 2009, compared to $3.5 million in 2008. Direct marketing expenses for the Other Affinity Networks segment increased 8.0% to $8.5 million for the year ended December 31, 2009, compared to $7.9 million in 2008. The increased marketing expense reflects management s focus on increasing market share and cultivating greater brand awareness for a handful of Web sites through online marketing channels. Direct marketing expenses for the Offline and Other Businesses segment decreased 52.1% to $541,000 for the year ended December 31, 2009, compared to $1.1 million in 2008 reflecting lower direct costs for our live events and fewer travel offerings compared to 2008.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses decreased 17.2% to $3.5 million for the year ended December 31, 2009, compared to $4.2 million in 2008. The decrease in total dollars was primarily attributed to a $498,000 decrease in lower stock-based compensation expense, reflecting the impact of re-priced options in the first quarter of 2009.

Customer Service. Customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members. Customer service expenses decreased 21.0% to $1.8 million for the year ended December 31, 2009, compared to $2.3 million in 2008. The decrease in dollar terms is primarily due to lower wages and third-party consulting costs, reflecting the completion of the migration of our customer service group from Beverly Hills, California to Provo, Utah.

Technical Operations. Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses decreased 21.5% to $1.5 million for the year ended December 31, 2009, compared to $1.9 million in 2008. The decrease in total dollars is due primarily to a reduction in stock-based compensation.

Development. Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses decreased by 12.7% to $3.9 million for the year ended December 31, 2009, compared to $4.5 million in 2008. The decrease in total dollars is primarily due to lower stock-based compensation.

General and Administrative. General and administrative expenses consist primarily of corporate personnel-related costs, professional fees, occupancy and other overhead costs. General and administrative expenses decreased 25.3% to $9.9 million for the year ended December 31, 2009, compared to $13.3 million in 2008. The decrease in total dollars was primarily attributable to a $1.3 million reduction in stock-based compensation expense and a $1.5 million decrease in professional service fees.

Depreciation Expense. Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expense remained flat at $873,000 for the year ended December 31, 2009, compared to $867,000 in 2008.

Amortization of Intangible Assets Other Than Goodwill. Amortization expenses consist primarily of amortization of intangible assets related to acquisitions, primarily MingleMatch, LDSSingles and HurryDate. Amortization expense decreased 15.8% to $663,000 for the year ended December 31, 2009, compared to $787,000 in 2008. The decrease reflects the fully amortized costs associated with HurryDate members and subscribers in early 2008.

Interest Income/Loss and Other Expenses, Net. Interest income/loss and other expenses consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Interest and other income or expense was income of $1.1 million for the year ended December 31, 2009, compared to expense of $107,000 in 2008. The income primarily reflects a $1.5 million gain associated with the possession of certain assets pursuant to a judgment awarded in favor of the Company.

Net (loss) income. Net loss was $(6.4) million for the year ended December 31, 2009, compared to net income of $4.8 million in 2008. The lower net income was primarily due to a decrease in revenue, contribution and an impairment expense related to goodwill and other long-lived assets.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Revenue

Substantially all of our revenue is derived from subscription fees. Approximately 6% and 5% of our revenue for the years ended December 31, 2008 and 2007, respectively, is generated through offline social and travel events, and advertising revenue. Revenue is presented net of credits and credit card chargebacks. In the case of subscription revenue, recognition occurs ratably over the subscription period and typically represents one month, three month, five month, six month and twelve month terms. We offer discounts to subscribers of plans covering more than one month. Most of our subscription plans have an automatic renewal feature upon expiration of the then current plan.

Revenue for the year ended December 31, 2008 decreased 12.2% to $57.3 million from $65.2 million in 2007. The revenue decrease can be primarily attributed to a 50.6% decrease in our General Market Networks business.

Revenue for the Jewish Networks segment was flat at $33.7 million for the year ended December 31, 2008, compared to $33.6 million in 2007. Revenue for the General Market Networks segment decreased 50.6% to $7.8 million for the year ended December 31, 2008, compared to $15.7 million in 2007. The decrease in General Market Networks revenue is due to a decrease in average paying subscribers, reflecting management s decision to eliminate inefficient online marketing expenses. Revenue for our Other Affinity Networks segment increased 3.3% to $13.7 million for the year ended December 31, 2008, compared to $13.3 million in 2007. The increase in revenue for our Other Affinity Networks is primarily attributed to a 4.0% increase in average paying subscribers reflecting an increase in direct marketing expenses, improved customer acquisition efficiency and greater brand awareness. Revenue of our Offline and Other Businesses segment decreased 21.7% to $2.0 million for the year ended December 31, 2008 compared to $2.6 million in 2007. The decrease in revenue is attributable to lower revenue from our speed dating events and fewer travel offerings versus 2007.

Costs and Expenses

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses decreased 22.1% to $47.9 million for the year ended December 31, 2008, compared to $61.6 million in 2007. Excluding asset impairment charges, the decrease in costs and expenses was primarily attributable to a $6.5 million decrease in cost of revenue and a $5.4 million decrease in general and administrative expenses.

Cost of Revenue. Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue decreased 25.7% to $18.7 million for the year ended December 31, 2008, compared to $25.1 million in 2007. The decrease can be primarily attributed to a $5.0 million reduction in direct marketing expenses associated with the General Market Networks segment, reflecting management s decision to acquire subscribers at more acceptable returns on investment. Direct marketing expenses for the Jewish Networks segment decreased 23.2% to $2.5 million for the year ended December 31, 2008, compared to $3.3 million in 2007. The decrease in marketing expense reflects a shift to more efficient online marketing programs from less efficient offline marketing channels. Direct marketing expenses for the General Market Networks segment decreased 58.8% to $3.5 million for the year ended December 31, 2008, compared to $8.5 million in 2007. The decrease reflects management s decision to eliminate inefficient marketing expenses. Direct marketing expenses for the Other Affinity Networks segment increased 0.6% to $7.9 million for the year ended December 31, 2008, compared to $7.8 million in 2007. The increased marketing expense reflects management s focus on increasing market share and cultivating greater brand awareness for the Web sites within this growing segment. Direct marketing expenses for the Offline and Other Businesses segment decreased 26.0% to $1.1 million for the year ended December 31, 2008, compared to $1.5 million in 2007 reflecting lower direct costs for our live events and fewer travel offerings compared to 2007.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses increased 16.8% to $4.2 million for the year ended December 31, 2008, compared to $3.6 million in 2007. The increase in total dollars was primarily due to an increase in our core marketing staff.

Customer Service. Customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members. Customer service expenses decreased 23.2% to $2.3 million for the year ended December 31, 2008, compared to $3.0 million in 2007. The decrease is primarily due to lower labor and third-party consulting costs, reflecting a reallocation of resources to our Utah office.

Table of Contents

Technical Operations. Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expense was flat at $1.9 million for the years ended December 31, 2008 and 2007.

Development. Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses increased by 5.0% to $4.5 million for the year ended December 31, 2008, compared to $4.2 million in 2007. The increase in total dollars is primarily due to additional personnel and consulting expenses.

General and Administrative. General and administrative expenses consist primarily of corporate personnel-related costs, professional fees and occupancy and other overhead costs. General and administrative expenses decreased 28.8% to $13.3 million for the year ended December 31, 2008, compared to $18.7 million in 2007. The decrease in total dollars was primarily attributable to $1.9 million of Scheme of Arrangement costs incurred in 2007, a $1.2 million decrease in stock-based compensation expense, an $800,000 decrease in professional service fee and a $525,000 decrease in personnel costs.

Depreciation Expense. Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expense decreased 48.5% to $867,000 for the year ended December 31, 2008, compared to $1.7 million in 2007. The decrease reflects the fully depreciated assets purchased in prior years.

Amortization of Intangible Assets Other Than Goodwill. Amortization expenses consist primarily of amortization of intangible assets related to acquisitions, primarily MingleMatch, LDSSingles and HurryDate. Amortization expense decreased 42.0% to $787,000 for the year ended December 31, 2008, compared to $1.4 million in 2007. The decrease reflects the fully amortized costs associated with HurryDate members and subscribers in 2007 and early 2008.

Interest Income/Loss and Other Expenses, Net. Interest income/loss and other expenses consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Net interest expense was $107,000 for the year ended December 31, 2008, compared to net interest income of $913,000 in 2007 reflecting the interest expense associated with our revolving borrowings, lower interest income due to a lower average cash balance and lower interest rates.

Net Income. Net income decreased 46.7% to $4.8 million for the year ended December 31, 2008, compared to $9.0 million in 2007. The lower net income was primarily due to an income tax benefit in 2007 resulting from the release of valuation allowances on our net operating losses.

Table of Contents

Quarterly Results of Operations

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

	Three Months Ended (1) (in thousands)							
	Dec. 31, 2009	Sept. 30, 2009	June 30, 2009	March 31, 2009	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008	March 31, 2008
Consolidated Statement of Operations Data:								
Revenue	$ 11,056	$ 11,058	$ 11,242	$ 12,032	$ 13,216	$ 14,041	$ 14,987	$ 15,022
Cost of revenue	3,953	3,849	3,755	3,650	4,309	4,337	5,003	5,066
Sales and marketing	904	845	837	921	971	1,082	1,128	1,053
Customer service	400	450	437	545	511	599	581	628
Technical operations	376	342	393	393	421	491	508	497
Development	674	899	1,055	1,267	1,005	1,134	1,103	1,221
General and administrative	2,390	2,311	2,453	2,778	3,180	3,263	3,341	3,506
Depreciation	236	236	195	206	218	226	178	245
Amortization	165	127	187	184	129	107	222	329
Impairment of goodwill and other assets	11,119			880	1,235	119		
Total operating expenses	20,217	9,059	9,312	10,824	11,979	11,358	12,064	12,545
Income (loss) from operations	(9,161)	1,999	1,930	1,208	1,237	2,683	2,923	2,477
Income (loss) before income taxes	(9,499)	2,043	3,815	716	721	2,534	3,147	2,811
Provision for income taxes	109	1,036	1,928	405	885	789	1,506	1,245
Net income (loss)	$ (9,608)	$ 1,007	$ 1,887	$ 311	$ (164)	$ 1,745	$ 1,641	$ 1,566
Basic and diluted net (loss) income per share	$ (0.47)	$ 0.05	$ 0.09	$ 0.02	$ (0.01)	$ 0.08	$ 0.07	$ 0.06
Shares used in computation of basic net income per share(1)	20,582	20,582	20,568	20,548	21,300	22,751	24,555	26,004
Shares used in computation of diluted net income per share	20,582	20,582	20,574	20,563	21,300	22,770	24,575	26,027
Average paying subscribers(2)	168,646	165,206	163,217	168,004	177,011	187,682	190,455	192,325
Costs and expenses include stock-based compensation as follows:								
Cost of Revenue	$ 3	$ 2	$ 2	$ 10	$ 10	$ 11	$ 12	$ 12
Sales and Marketing	49	44	43	48	135	157	196	194
Customer Service	(23)	2	2	5	13	13	17	22
Technical Operations	44	37	37	40	81	157	159	160
Development	(55)	22	21	41	96	138	159	160
General and administrative	162	161	163	181	422	501	524	519
Total Stock Based compensation	$ 180	$ 268	$ 268	$ 325	$ 757	$ 977	$ 1,067	$ 1,067

(1) For information regarding the computation of per share amounts, refer to Note 1 of our consolidated financial statements.

(2) Represents average paying subscribers calculated as the sum of the average paying subscribers for each month, divided by the number of months. Average paying subscribers for each month are calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two.

Table of Contents

Liquidity and Capital Resources

As of December 31, 2009, we had cash and cash equivalents of $6.2 million. We have historically financed our operations with internally generated funds and offerings of equity securities.

Net cash provided by operations was $5.9 million for the year ended December 31, 2009 compared to $12.3 million for the same period in 2008. The decrease is primarily due to less cash generated from operations. Approximately $3.2 million of excess tax benefits from stock-based compensation has been deducted from net cash provided by operations and added back under the Cash Flows from Financing Activities section of the Consolidated Statements of Cash Flows.

Net cash used by investing activities was $2.8 million for 2009 compared to $3.0 million for 2008. In 2009, the Company purchased fixed assets of $1.4 million, primarily representing computer hardware and capitalized software. In addition, $1.4 million was paid to the former owners of HurryDate pursuant to an earn-out arrangement. In 2008, the Company purchased fixed assets of $1.3 million, representing computer hardware and software and leasehold improvements. In addition, $1.1 million was used for the purchase of certain assets of an online business, and $770,000 was paid to the former owners of HurryDate pursuant to an earn-out arrangement.

Net cash used for financing activities was $4.3 million for the year ended December 31, 2009 compared to $10.7 million for 2008. Cash used for financing activities in 2009 was primarily related to payment of the short-term borrowings from our line of credit totaling $7.5 million offset by the recognition of an excess tax benefit from stock-based compensation of $3.2 million. Cash used for financing activities in 2008 was primarily related to the repurchase of the Company s common stock through various open market and private placement transactions totaling $20.8 million, offset by net short-term borrowings from our line of credit totaling $7.5 million and the recognition of an excess tax benefit from stock-based compensation of $3.0 million.

On February 14, 2008, the Company and its wholly-owned subsidiary, Spark Networks Limited, as borrower, entered into an agreement (the Initial Agreement) with Bank of America for a $30.0 million revolving credit facility, which was amended to $25.0 million on September 29, 2009 (the Amended Agreement).

The Amended Agreement, among other things, increases the per annum interest rate under the Agreement, which is based upon a financial leverage ratio of less than 1.00, 1.00 to 1.49 and 1.50 and greater. The corresponding interest rates on LIBOR based borrowings are increased to LIBOR plus 1.75%, 2.00% and 2.50%, respectively. In the event the Company elects to borrow under a base rate loan, the corresponding interest rates are increased to the prime rate plus, 0.75%, 1.00% and 1.50%, respectively. Under the Amended Agreement, the Company pays a 0.250% to 0.375% per annum commitment fee on all funds not utilized under the facility, measured on a daily basis.

The Amended Agreement requires the Company to maintain a consolidated leverage ratio at any time during any period of four fiscal quarters of no greater than 2.00 to 1.00 for quarters through December 31, 2009 and 1.50 to 1.00 for quarters on and after March 31, 2010, and a consolidated adjusted EBITDA of $9 million for the quarters ending September 30, 2009 through December 31, 2009 and $8 million for the quarters ending on and after March 31, 2010. In addition, the Amended Agreement requires the Company to maintain a fixed charge coverage ratio for each period of four consecutive fiscal quarters of no less than 1.25 to 1.00 through the quarter ending September 30, 2009 and 1.50 to 1.00 for the quarters ending on or after December 31, 2009.

As of December 31, 2009, we were in compliance with the covenants related to our Credit agreement. At December 31, 2009, there was no balance outstanding under the Credit Agreement. In connection with the Initial Agreement, the Company paid deferred financing costs of approximately $446,000. Costs associated with both the Initial and the Amended Agreements were included in other current assets and deposits and other assets. In the third quarter of 2009, the Company wrote off $36,000 of the remaining deferred financing costs associated with the Initial Agreement, reflecting a $5.0 million reduction in the revolving credit facility. The remaining deferred financing costs are amortized to interest expense in the Consolidated Statements of Operations over the full term of the Amended Agreement. Amortization expense for the deferred financing costs for the year ended December 31, 2009 and December 31, 2008 were $148,000 and $136,000, respectively.

We believe that our current cash and cash equivalents, marketable securities and cash flow from operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and contractual obligations, for at least the next 12 months. We had positive operating cash flow in 2009 and anticipate continued positive cash flow from operations. We do not anticipate requiring additional capital; however, if required or desirable, we may utilize our revolving credit facility, or raise additional debt or issue additional equity in the private or public markets.

Contractual Obligations

The following table describes our contractual commitments and obligations as of December 31, 2009 (in thousands):

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
Operating leases	$ 1,220	$ 957	$	$	$ 2,177
Other commitments and obligations	272	134			406
Total contractual obligations	$ 1,492	$ 1,091	$	$	$ 2,583

We had commitments and obligations consisting of operating leases, contracts with software licensing, communications, computer hosting and marketing service providers. Other commitments and obligations totaled $272,000 for less than one year and $134,000 between one and three years. Contracts with other service providers are for 30 day terms or less. For contingences related to our tax positions, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months. As a result, this amount is not included in the table above.

Off-Balance Sheet Arrangements

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

Recent Accounting Developments

In December 2007, the Financial Accounting Standards Board (FASB) issued new guidance for accounting for business combinations and for non-controlling interests in consolidated financial statements. The new treatment requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. The Non-controlling Interests in Consolidated Financial Statements guidance clarifies that a non-controlling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. The effective date is for financial statements issued for fiscal years beginning after December 15, 2008. The Company adopted both guidance as of January 1, 2009 and such adoption did not have a material effect on the Company s consolidated financial position or results of operations.

In April 2008, the FASB issued the new guidance for determination of the useful life of intangible assets. It amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of the amended guidance is to improve the consistency between the useful life of a recognized intangible asset under the prior one and the period of expected cash flows used to measure the fair value of the assets under the new guidance and other guidance under GAAP. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company adoption date was January 1, 2009 and it did not have a material effect on the Company s consolidated financial position or results of operations.

In April 2009, the FASB issued the accounting guidance for interim disclosures about fair value of financial instruments. It requires disclosures about the fair value of financial instruments in interim and annual financial statements. The guidance is effective for periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted the guidance in the quarter ended June 30, 2009. Because the new guidance amends only the disclosure requirements related to the fair value of financial instruments, the adoption did not affect the Company s consolidated financial condition and results of operations.

In May 2009, the FASB issued a new accounting standard which established general accounting standards and disclosure for subsequent events. The new requirement establishes the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. We evaluated subsequent events through the date we filed this annual report on Form 10-K with the Securities and Exchange Commission (SEC).

In August 2009, the FASB issued a new accounting standard which provides additional guidance on the measurement of liabilities at fair value. Specifically, when a quoted price in an active market for the identical liability is not available, the new standard requires that the fair value of a liability be measured using one or more of the valuation techniques that should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. In addition, an entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of a liability. We adopted this standard in the fourth quarter of 2009 and the adoption did not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued a new accounting standard which provides guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management s best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. In October 2009, the FASB also issued a new accounting standard which changes revenue recognition for tangible products containing software and hardware elements. Specifically, tangible products containing software and hardware that function together to deliver the tangible products essential functionality are scoped out of the existing software revenue recognition guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance discussed above. Both standards will be effective for us in the first quarter of 2011. Early adoption is permitted. The Company has not yet determined the effect that the adoption of this accounting standard will have on its consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable for a smaller reporting company.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2009.

Internal Control Over Financial Reporting

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

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of the Company s management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on criteria established in the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, the Company s management concluded that its internal control over financial reporting was effective as of December 31, 2009.

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

(b) Attestation Report

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

(c) Changes in internal control over financial reporting

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

ITEM 9B. OTHER INFORMATION

None.

Table of Contents

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

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

ITEM 11. EXECUTIVE COMPENSATION.

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

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

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

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

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

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

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

Table of Contents

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

(a)(3) Exhibits

Exhibit Number	Description of Exhibit
2.1	Scheme of Arrangement effective July 9, 2007 (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
3.1	Certificate of Incorporation of Spark Networks, Inc. (incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
3.2	Certificate of Designation of Series C Preferred Stock (incorporated by reference to Exhibit 3.1(A) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
3.3	Amended and Restated Bylaws effective November 11, 2009 of Spark Networks, Inc. (incorporated by reference to Exhibit 3.2 of the Registrant s Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 12, 2009).
4.1	Rights Plan Dated July 9, 2007 Between Spark Networks, Inc. and The Bank of New York (incorporated by reference to Exhibit 4.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.1	Lease dated September 1, 2000 between Arden Realty Limited Partnership and the Registrant regarding 8383 Wilshire Boulevard (incorporated by reference to exhibit 10.1 of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(a)	First Amendment to Lease, dated September 5, 2000 (incorporated by reference to exhibit 10.1(a) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(b)	Second Amendment to Lease, dated January 16, 2003 (incorporated by reference to exhibit 10.1(b) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(c)	Third Amendment to Lease, dated October 30, 2003 (incorporated by reference to exhibit 10.1(c) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(d)	Fourth Amendment to Lease, dated May 14, 2004 (incorporated by reference to exhibit 10.1(d) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(e)	Fifth Amendment to Lease, dated February 22, 2006 (incorporated by reference to Exhibit 10.1(e) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).
10.1(f)	Sixth Amendment to Lease, dated March 7, 2007 (incorporated by reference to Exhibit 10.1(f) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007).

Table of Contents

Exhibit Number	Description of Exhibit
10.1(g)	Seventh Amendment to Lease, dated November 27, 2007 (incorporated by reference to Exhibit 10.1(g) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2008).
10.2	2004 Share Option Scheme (incorporated by reference to Exhibit 10.2 of the Registrant s Registration Statement on Form S-1 (File No. 333-123228) filed with the Securities and Exchange Commission on March 10, 2005).
10.2(a)	Form of Option Agreement for 2004 Share Option Scheme (incorporated by reference to Exhibit 10.2(a) of the Registrant s Registration Statement on Form S-1/A (File No. 333-123228) filed with the Securities and Exchange Commission on November 14, 2005).
10.3	2000 Executive Share Option Scheme (incorporated by reference to Exhibit 10.3 of the Registrant s Registration Statement on Form S-1 (File No. 333-123228) filed with the Securities and Exchange Commission on March 10, 2005).
10.3(a)	Form of Option Agreement for 2000 Executive Share Option Scheme (incorporated by reference to Exhibit 10.3(a) of the Registrant s Registration Statement on Form S-1 (File No. 333-123228) filed with the Securities and Exchange Commission on November 14, 2005).
10.4	Amendments to the 2000 Executive Share Option Scheme and the 2004 Share Option Schemes, each dated November 25, 2008 (incorporated by reference to Exhibit d(6) to the Registrant s Schedule TO filed with the Securities and Exchange Commission on December 2, 2008).
10.5(a)	Executive Employment Agreement, dated August 31, 2005, between the Registrant and Gregory R. Liberman (incorporated by reference to Exhibit 10.13 of the Registrant s Registration Statement on Form S-1/A (File No. 333-123228) filed with the Securities and Exchange Commission on September 16, 2005).
10.5(b)	Amendment No. 1, dated March 15, 2006, to the Executive Employment Agreement between the Registrant and Gregory R. Liberman (incorporated by reference to Exhibit 10.13(a) of the Registrant s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on April 7, 2006).
10.5(c)	Amendment No. 2, dated November 27, 2006, to Executive Employment Agreement between the Registrant and Gregory R. Liberman (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on November 30, 2006).
10.5(d)	Amendment No. 3, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Gregory R. Liberman (incorporated by reference to Exhibit 10.4 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2008).
10.6	Standstill Agreement entered into by the Registrant and Great Hill Equity Partners II on December 1, 2005 (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 7, 2005).
10.7(a)	Executive Employment Agreement, dated February 12, 2007, between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on February 13, 2007).
10.7(b)	Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).

Table of Contents

Exhibit Number	Description of Exhibit
10.8	Consent to Assignment and Assumption of Standstill Agreement with Great Hill Equity Partners II (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.9	Amendments to 2000 and 2004 Option Schemes (incorporated by reference to Exhibit 10.3 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.10	Form of Indemnification Agreement with Officers and Directors (incorporated by reference to Exhibit 10.4 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.11	Schedule of Officers and Directors who entered into Indemnification Agreements (incorporated by reference to Exhibit 10.12(a) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2008).
10.12(a)	Employment Agreement dated July 2, 2007 between Spark Networks plc and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.5 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.12(b)	Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.3 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
10.13(a)	2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.13(b)	Amendment No. 1 to the 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on January 6, 2009).
10.14	Form of Stock Option Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(A) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.15	Form of Restricted Stock Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(B) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.16	Form of Restricted Stock Unit Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(C) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.17(a)	Executive Employment Agreement dated May 16, 2007 between Spark Networks plc and Gregory J. Franchina (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 21, 2007).
10.17(b)	Amendment No. 1, dated December 30, 2008, to Executive Employment Agreement between the Registrant and Gregory J. Franchina (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
10.18(a)	Executive Employment Agreement executed November 27, 2007 between Spark Networks, Inc. and Brett Zane (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on November 27, 2007).

Exhibit Number	Description of Exhibit
10.18(b)	Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Brett Zane (incorporated by reference to Exhibit 10.5 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
10.19	Credit Agreement dated February 14, 2008 among Spark Networks Limited, Spark Networks, Inc. and Bank of America, N.A. (incorporated by reference to Exhibit 10.01 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on February 19, 2008).
10.19(a)	First Amendment to Credit Agreement dated as of September 29, 2009 among Spark Networks Limited, Spark Networks, Inc., Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on September 29, 2009).
21.1	List of subsidiaries (incorporated by reference to Exhibit 21.1 of the Registrant s Annual Report on Form 10-K (File No. 001-32750) filed with the Securities and Exchange Commission on March 26, 2009)
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
31.1	Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Beverly Hills, State of California, on March 25, 2010.

SPARK NETWORKS, INC.

/s/ ADAM S. BERGER
Adam S. Berger
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Position	Date
/s/ ADAM S. BERGER Adam S. Berger	Chief Executive Officer (Principal Executive Officer) and Director	March 25, 2010
/s/ BRETT A. ZANE Brett A. Zane	Chief Financial Officer (Principal Financial and Accounting Officer)	March 25, 2010
/s/ JONATHAN B. BULKELEY Jonathan B. Bulkeley	Director	March 25, 2010
/s/ BENJAMIN A. DERHY Benjamin A. Derhy	Director	March 25, 2010
/s/ MICHAEL A. KUMIN Michael A. Kumin	Director	March 25, 2010
/s/ THOMAS G. STOCKHAM Thomas G. Stockham	Director	March 25, 2010

Table of Contents

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Spark Networks, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spark Networks, Inc. at December 31, 2009 and 2008, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Los Angeles, California

March 25, 2010

Table of Contents

SPARK NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except stock data)

	December 31, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 6,223	$ 7,417
Restricted cash	681	766
Accounts receivable, net of allowance of $19 and $32	684	1,102
Deferred tax asset current	221	52
Prepaid expenses and other	853	1,869
Total current assets	8,662	11,206
Property and equipment, net	2,277	1,685
Goodwill	8,758	17,964
Intangible assets, net	3,586	5,750
Deferred tax asset non-current	4,707	5,002
Deposits and other assets	1,866	401
Total assets	$ 29,856	$ 42,008
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,415	$ 2,260
Accrued liabilities	4,232	4,830
Deferred revenue	4,244	4,093
Notes payable		7,750
Total current liabilities	9,891	18,933
Deferred tax liability	663	756
Other liabilities non-current	978	906
Total liabilities	11,532	20,595
Commitments and contingencies (Note 12)		
Stockholders equity:		
Authorized capital stock consists of 100,000,000 shares of Common Stock, $0.001 par value; 20,581,544 issued and outstanding at December 31, 2009 and 20,541,744 shares of Common Stock as of December 31, 2008, at stated values of:	21	21
Additional paid-in-capital	48,813	45,545
Accumulated other comprehensive income	638	591
Accumulated deficit	(31,148)	(24,744)
Total stockholders equity	18,324	21,413
Total liabilities and stockholders equity	$ 29,856	$ 42,008

See accompanying notes.

Table of Contents

SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Years Ended December 31,		
	2009	**2008**	**2007**
Revenue	$ 45,388	$ 57,266	$ 65,218
Cost and expenses:			
Cost of revenue (exclusive of depreciation shown separately below)	15,207	18,715	25,183
Sales and marketing	3,507	4,234	3,626
Customer service	1,832	2,319	3,018
Technical operations	1,504	1,917	1,906
Development	3,895	4,463	4,249
General and administrative	9,932	13,290	18,671
Depreciation	873	867	1,684
Amortization of intangible assets other than goodwill	663	787	1,356
Impairment of goodwill, long-lived assets and other assets	11,999	1,354	1,894
Total cost and expenses	49,412	47,946	61,587
Operating income (loss)	(4,024)	9,320	3,631
Interest (income) and other expenses, net	(1,099)	107	(913)
Income (loss) before income taxes	(2,925)	9,213	4,544
Provision (benefit) for income taxes	3,479	4,425	(4,434)
Net income (loss)	$ (6,404)	$ 4,788	$ 8,978
Net income (loss) per share basic and diluted	$ (0.31)	$ 0.20	$ 0.31
Weighted average shares outstanding basic	20,570	23,637	29,218
Weighted average shares outstanding diluted	20,570	23,640	29,250

	Years Ended December 31,		
Stock-Based Compensation	**2009**	**2008**	**2007**
		(in thousands)	
Cost of revenue	$ 17	$ 44	$ 35
Sales and marketing	184	682	884
Customer service	(14)	65	117
Technical operations	158	558	598
Development	29	553	534
General and administrative	667	1,966	3,153

See accompanying notes.

Table of Contents

SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Ordinary Shares/ Common Stock Shares	Ordinary Shares/ Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
BALANCE, December 31, 2006	30,941	$ 517	$ 67,571	$ 248	$ (38,510)	$ 29,826
Issuance of ordinary shares upon exercise of share options and warrants	580	6	1,713			1,719
Reclasses to shares subject to rescission		(9)	608			599
Excess tax benefits from stock-based comp			(2)			(2)
Purchase of shares for retirement	(5,388)	(54)	(23,401)			(23,455)
Foreign currency translation adjustment			18	417		435
Unrealized gain on marketable securities				7		7
Stock-based compensation			5,321			5,321
Reclassification for change in par value		(434)	434			
Net income					8,978	8,978
BALANCE, December 31, 2007	26,133	$ 26	$ 52,262	$ 672	$ (29,532)	$ 23,428
Issuance of ordinary shares upon exercise of share options and warrants	23	1	9			10
Reclasses to shares subject to rescission			7,480			7,480
Excess tax benefits from stock-based comp			2,733			2,733
Purchase of shares for retirement	(5,614)	(6)	(20,807)			(20,813)
Unrealized loss on marketable securities				(9)		(9)
Foreign currency translation adjustment				(72)		(72)
Stock-based compensation			3,868			3,868
Net income					4,788	4,788
BALANCE, December 31, 2008	20,542	$ 21	$ 45,545	$ 591	$ (24,744)	$ 21,413
Issuance of common stock upon exercise of stock options	40		30			30
Excess tax benefits from stock-based comp			2,197			2,197
Foreign currency translation adjustment, net of tax				47		47
Stock-based compensation			1,041			1,041
Net loss					(6,404)	(6,404)
BALANCE, December 31, 2009	20,582	$ 21	$ 48,813	$ 638	$ (31,148)	$ 18,324

See accompanying notes.

F-5

Table of Contents

SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years Ended December 31, 2009	2008	2007
Cash flows from operating activities:			
Net income (loss)	$ (6,404)	$ 4,788	$ 8,978
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Depreciation and amortization	1,536	1,654	3,040
Impairment of goodwill, long-lived assets and other assets	11,999	1,354	1,894
Stock-based compensation	1,041	3,868	5,321
Non-current taxes payable and other	(42)	(69)	860
Foreign exchange gain on intercompany loan	(30)	(41)	(204)
Income from asset received from legal judgment	(1,507)		
Excess tax benefits from stock-based compensation	(3,207)	(3,032)	
Deferred taxes	2,232	3,052	(6,150)
Changes in operating assets and liabilities:			
Accounts receivable	418	331	(330)
Restricted cash	84	898	364
Prepaid expenses and other assets	1,089	(467)	265
Accounts payable and accrued liabilities	(1,443)	30	643
Deferred revenue	151	(46)	89
Net cash provided by operating activities	5,917	12,320	14,770
Cash flows from investing activities:			
Sale of marketable securities		200	
Sale of property and equipment			25
Purchases of property and equipment	(1,440)	(1,301)	(734)
Purchases of businesses and intangible assets	(32)	(1,111)	(2,620)
Earn out payment for acquisition of business	(1,355)	(770)	
Net cash used in investing activities	(2,827)	(2,982)	(3,329)
Cash flows from financing activities:			
Proceeds from issuance of stock	30	10	1,719
Purchase of stocks for retirement		(20,813)	(23,455)
Principal payments of capital lease obligations			(102)
Excess tax benefits from stock-based compensation	3,207	3,032	(2)
Proceeds from borrowing on revolving credit facility		10,000	
Payment on borrowing on revolving credit facility	(7,500)	(2,500)	
Payment of deferred financing costs	(21)	(446)	
Principal payments of notes payable			(1,217)
Net cash used in financing activities	(4,284)	(10,717)	(23,057)
Net decrease in cash	(1,194)	(1,379)	(11,616)
Cash and cash equivalents at beginning of year	7,417	8,796	20,412
Cash and cash equivalents at end of year	$ 6,223	$ 7,417	$ 8,796

Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 159	$ 140	$ 31
Cash paid for income taxes	$ 1,232	$ 1,345	$ 1,665
Supplemental disclosure of non-cash investing and financing activities:			
Hold-back in acquisition of business	$ (250)	$ 250	

See accompanying notes.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Summary of Significant Accounting Policies

The Company

Prior to July 9, 2007, Spark Networks plc (now, known as Spark Networks Limited) was a public limited company incorporated under the laws of England and Wales (Limited). Since the completion of our reorganization on July 9, 2007 through a shareholder vote and court process in the United Kingdom known as a Scheme of Arrangement , the common stock of Spark Networks, Inc., a Delaware corporation and Limited s parent entity (the Company), has traded on the NYSE Amex (formerly the American Stock Exchange) and the Company has become Limited s successor reporting entity. The Company and its consolidated subsidiaries provide online personals services in the United States and internationally, whereby adults are able to post information about themselves (profiles) on the Company s Web sites and search and contact other individuals who have posted profiles.

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

Principles of Consolidation

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

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

Effective September 24, 2007, the nature of the intercompany loan between the Company and its Israel subsidiary was changed from a long term investment to a loan which the Company expects to be settled. The foreign exchange gains and losses related to this loan are recorded as part of net income and excluded from accumulated other comprehensive income (loss). For the years ended December 31, 2009 and 2008, the Company recorded a foreign exchange gain of approximately $30,000 and $41,000 related to the intercompany loan, respectively.

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

Reclassification

Certain prior year financial information has been reclassified to conform to current year classifications.

Revenue Recognition and Deferred Revenue

Substantially all of the Company s revenue is derived from subscription fees. Revenue is presented net of credits and credit card chargebacks. The Company recognizes revenue in accordance with accounting principles generally accepted in the United States. Revenue recognition occurs ratably over the subscription period,

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

beginning when there is persuasive evidence of an arrangement, delivery has occurred (access has been granted), the fees are fixed or determinable, and collection is reasonably assured. Subscribers pay in advance, primarily by using a credit card, and, subject to certain conditions identified in our terms and conditions, all purchases are final and nonrefundable. Fees collected in advance for subscriptions are deferred and recognized as revenue using the straight line method over the term of the subscription.

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

Fair Value Measurement

Effective January 1, 2008, the Company adopted accounting guidance for the method of fair value and disclosures as issued by the Financial Accounting Standards Board (FASB). It clarifies that fair value is an exit price, representing the amount that would be received in a sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activity.

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

As of December 31, 2009, the Company has financial assets that consist of cash and cash equivalents, which are measured at fair value using quoted prices for identical assets in an active market (Level 1 fair value hierarchy) in accordance with the latest guidance.

Cash and Cash Equivalents

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

Marketable Securities

The Company makes temporary investments of cash in liquid interest bearing accounts and marketable securities. Marketable securities are classified as available for sale, and are stated at fair market value, with any unrealized gains or losses reported as other comprehensive income (loss) under stockholders equity in the accompanying consolidated balance sheets. Realized gains or losses and declines in value that are other than temporary, if any, on available-for-sale securities are calculated using the specific identification method and are reported in other income or expense as incurred.

Investment in marketable securities consists of government debt securities with maturities between five to ten years. The fair value of the available for sale securities approximates their carrying value (amortized cost). Unrealized gains and losses were immaterial. The Company sold all of its marketable securities in 2008.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Cash

The Company s credit card processors regularly withhold deposits and maintain balances which the Company records as restricted cash. As of December 31, 2009 and 2008, the Company had $681,000 and $766,000 in restricted cash, respectively.

Accounts Receivable

Accounts receivable is primarily composed of credit card payments for membership fees pending collection from the credit card processors and to a much smaller extent, receivables for advertising sales. The Company records a reserve based on historical chargeback levels experienced over the preceding three-month period and reviews its accounts receivable from advertisers on a monthly basis. The allowance for doubtful accounts as of December 31, 2009 and 2008 is $19,000 and $32,000, respectively. The chargeback reserve as of December 31, 2009 and 2008 was approximately $0 and $12,000, respectively.

Prepaid Advertising Expenses

In certain circumstances, the Company pays in advance for Internet based advertising on other contracted Web sites, and expenses the prepaid amounts over the contract periods as the contracted Web site delivers on their commitment. The Company evaluates the realization of prepaid amounts at each reporting period, and expenses prepaid amounts upon delivery of services or if it determines that the contracted Web site will be unable to deliver on its commitment and is not willing or able to repay the undelivered prepaid amounts.

Web Site and Software Development Costs

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

In accordance with the Accounting for Web Site Development Costs guidance, the Company expenses costs related to the planning and post implementation phases of Web site development efforts. Direct costs incurred in the development phase are capitalized. Costs associated with minor enhancements and maintenance for the Web site are included in expenses in the accompanying consolidated statements of operations.

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

	2009	2008	2007
Capitalized	$ 874	$ 605	$ 152
Expensed	(176)	(143)	(290)
Impairment	(110)	(119)	
Unamortized Balance	$ 1,146	$ 558	$ 215

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property and Equipment

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

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired resulting from business acquisitions, specifically allocated to reporting units. The Company determines its reporting unit and operating segment through the use of the management approach. The management approach considers the internal organizational structure used by the Company s chief operating decision maker for making operating decisions and assessing performance. Annually, the Company analyzes the fair value of each reporting unit to assess if the fair value exceeds the carrying value. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices or appraised values, depending on the nature of the assets. If fair value is below the carrying amount of the reporting unit, the company assesses what the fair value of the reporting unit is and impairs the excess. As of December 31, 2009 and 2008, the Company had unamortized goodwill of approximately $8.8 million and $18.0 million, respectively.

Intangible Assets

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

Impairment of Long-lived Assets

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

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

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2009, the Company impaired approximately $110,000 of capitalized software development costs when we determined that a web-based product failed to perform to Company standards.

In 2008, the Company impaired approximately $119,000 of capitalized software development costs when we determined that a web-based product failed to perform to Company standards.

Income Taxes

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

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

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

Cost of Revenue

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Direct marketing costs are expensed in the period incurred and primarily represent online marketing, including payments to search engines and affiliates, and offline marketing, including radio, billboards, and print advertising. For the years ended December 31, 2009, 2008 and 2007, the Company incurred direct marketing costs amounting to approximately $12.1 million, $15.0 million and $21.1 million respectively.

Sales and Marketing

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

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Customer Service

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

Technical Operations

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

Development

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

General and Administrative

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

Stock-based Compensation

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

Prior to our adoption of the guidance, the Company did not record tax benefits of deductions resulting from the exercise of share options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2009 and 2008, the Company recognized cash inflows of approximately $3.2 million and approximately $3.0 million, respectively, related to tax provision or benefit from stock-based compensation.

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

	2009	2008	2007
Expected life in years	4.56	4.56	4.56
Dividend per share			
Volatility	40.0-45.0%	40.0-45.0%	45.0%
Risk-free interest rate	2.0-3.0%	2.0-3.0%	4.0-4.5%

The Company used historical and empirical data to assess different forfeiture rates for three different groups of employees. The Company must reassess forfeiture rates when deemed necessary and it must calibrate actual forfeiture behavior to what has already been recorded. For 2009, 2008 and 2007, there were three groups of employees whose behavior was significantly different from each other. Therefore, the Company estimated different forfeiture rates for each group.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

The term of the options was derived based on the simplified method calculations. The Company is using the simplified method calculation, which is derived by averaging the vesting term with the contractual terms due to a change in the stock exchange on which the Company s stock was traded.

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

Comprehensive Income (Loss)

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For the Company, comprehensive income (loss) consists of its reported net income, the net unrealized gains or losses on marketable securities and translation adjustments. Comprehensive income for each of the periods presented is comprised as follows:

	Years Ended December 31, (in thousands)		
	2009	2008	2007
Net income (loss)	$ (6,404)	$ 4,788	$ 8,978
Changes in unrealized (losses)/gain in available for sale securities, net of taxes		(9)	7
Foreign currency translation adjustment	47	(72)	417
Total comprehensive income (loss)	$ (6,357)	$ 4,707	$ 9,402

Accumulated other comprehensive income consists of the following:

	As of December 31, (in thousands)		
	2009	2008	2007
Loss on marketable securities, net of taxes	$	$	$ 9
Foreign currency translation adjustment	638	591	663
Total accumulated other comprehensive income	$ 638	$ 591	$ 672

Fair Value of Financial Instruments

The Company s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, notes payable and obligations under capital leases are carried at cost, which approximates their fair value due to the short-term maturity of these instruments and variable interest rates for these instruments.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net Income (Loss) Per Share

The Company calculates net income (loss) per share and presents both basic and diluted net income (loss) per share as seen in the chart below. Basic net income (loss) per share is computed by dividing net income (loss) available to common stock holders by the weighted average number of common stock outstanding. Diluted net income (loss) per share includes the effect of potential common stock outstanding, including dilutive stock options and warrants, using the treasury stock method.

	For the Year Ended December 31,		
	2009	2008	2007
Net Income (Loss) Per Common Share Basic			
Net income (loss) applicable to common stock	$ (6,404)	$ 4,788	$ 8,978
Weighted average shares outstanding-basic	20,570	23,637	29,218
Basic Net Income (Loss) Per Share	**$ (0.31)**	**$ 0.20**	**$ 0.31**
Net Income (Loss) Per Common Share Diluted			
Net income (loss) applicable to common stock	$ (6,404)	$ 4,788	$ 8,978
Weighted average shares outstanding-basic	20,570	23,637	29,218
Dilutive options using the treasury stock method		3	32
Weighted average shares outstanding-diluted	20,570	23,640	29,250
Diluted Net Income (Loss) Per Share	**$ (0.31)**	**$ 0.20**	**$ 0.31**

Options to purchase 3.4 million, 3.4 million and 3.6 million shares for fiscal years 2009, 2008 and 2007, respectively, were not included in the computation of diluted net income per share because the grant price of such options was above the average stock price for the period and, therefore, the options were considered anti-dilutive.

Use of Estimates

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

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

Recent Accounting Developments

In December 2007, the Financial Accounting Standards Board (FASB) issued new guidance for accounting for business combinations and for non-controlling interests in consolidated financial statements. The new treatment requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. The Non-controlling Interests in Consolidated Financial Statements guidance

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

clarifies that a non-controlling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. The effective date is for financial statements issued for fiscal years beginning after December 15, 2008. The Company adopted both guidance as of January 1, 2009 and such adoption did not have a material effect on the Company s consolidated financial position or results of operations.

In April 2008, the FASB issued the new guidance for determination of the useful life of intangible assets. It amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of the amended guidance is to improve the consistency between the useful life of a recognized intangible asset under the prior one and the period of expected cash flows used to measure the fair value of the assets under the new guidance and other guidance under GAAP. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company adoption date was January 1, 2009 and it did not have a material effect on the Company s consolidated financial position or results of operations.

In April 2009, the FASB issued the accounting guidance for interim disclosures about fair value of financial instruments. It requires disclosures about the fair value of financial instruments in interim and annual financial statements. The guidance is effective for periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted the guidance in the quarter ended June 30, 2009. Because the new guidance amends only the disclosure requirements related to the fair value of financial instruments, the adoption did not affect the Company s consolidated financial condition and results of operations.

In May 2009, the FASB issued a new accounting standard which established general accounting standards and disclosure for subsequent events. The new requirement establishes the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. The Company evaluated subsequent events through the date we filed this annual report on Form 10-K with the Securities and Exchange Commission (SEC).

In August 2009, the FASB issued a new accounting standard which provides additional guidance on the measurement of liabilities at fair value. Specifically, when a quoted price in an active market for the identical liability is not available, the new standard requires that the fair value of a liability be measured using one or more of the valuation techniques that should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. In addition, an entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of a liability. The Company adopted this standard in the fourth quarter of 2009 and the adoption did not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued a new accounting standard which provides guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management s best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. In October 2009, the FASB also issued a new accounting standard which changes revenue recognition for tangible products containing software and hardware elements. Specifically, tangible products containing software and hardware that function together to deliver the tangible products essential functionality are scoped out of the existing software revenue recognition guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance discussed above. Both

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

standards will be effective for us in the first quarter of 2011. Early adoption is permitted. The Company has not yet determined the effect that the adoption of this accounting standard will have on its consolidated financial statements.

2. Income Taxes

	Year Ended December 31, 2009	2008 (in thousands)	2007
Income (loss) before income taxes			
U.S	$ (2,978)	$ 8,883	$ 3,379
Foreign	53	330	1,165
	$ (2,925)	$ 9,213	$ 4,544

	Year Ended December 31, 2009	2008 (in thousands)	2007
Provision (benefit) for income taxes			
Current			
Federal	$ 3,769	$ 3,152	$ 1,313
State	638	1,048	55
Foreign	52	209	348
	4,459	4,409	1,716
Deferred			
Federal	(1,145)	183	3,694
State	210	(327)	1,383
Foreign	(92)	162	315
	(1,027)	18	5,392
Valuation Allowance	47	(2)	(11,542)
	$ 3,479	$ 4,425	$ (4,434)

	Year Ended December 31, 2009	2008	2007
Reconciliation of Effective Income Tax Rate:			
Provision on earnings at federal statutory rate	34.0%	35.0%	35.0%
State tax provision, net of federal benefit	5.8	4.9	17.8
Goodwill Impairment	(126.4)		14.6
Nondeductible expenses	(1.9)	0.5	72.1
Tax reserves	(1.6)	0.6	16.7
Change in effective tax rates	(6.9)		
Foreign tax rate differential	(9.7)	0.5	5.6

Valuation allowance	(1.6)		(254.1)
Write down of deferred tax asset	(10.2)		
Other	(0.4)	6.6	(5.4)
Total provision (benefit) for income taxes	(118.9)%	48.1%	(97.7)%

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Although prior to July 7, 2007, the Company was incorporated as a public limited company in the United Kingdom, the majority of its global operations are currently subject to tax in the U.S. As a result, the Company believes it is more appropriate to use the U.S. Federal statutory rate to reconcile to its reported income tax rate.

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

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

	Year Ended December 31,		
	2009	2008 (in thousands)	2007
Net operating loss carry-forward	$ 691	$ 731	$ 2,964
Depreciation and amortization	1,546	818	190
Compensation accruals	2,022	2,914	1,862
Accruals and reserves	203	153	155
Excess capital loss over capital gain	140	54	56
Credits	793	614	545
Other	433	903	417
Total before valuation allowance	5,828	6,187	6,189
Less: Valuation allowance	(617)	(570)	(572)
Total deferred income tax asset	5,211	5,617	5,617
Deferred income tax liabilities			
Other	(946)	(1,319)	(1,012)
Accruals and reserves			
Amortization			
Total deferred income tax liabilities	(946)	(1,319)	(1,012)
Total net deferred income tax assets	$ 4,265	$ 4,298	$ 4,605

Due to uncertainty with regard to the Company s ability to realize certain deferred tax assets, the Company has maintained a valuation allowance of approximately $617,000 against its deferred tax assets as of December 31, 2009. In addition, as a result of a change in the expected future tax rate at our Israel subsidiary, the Company revalued our deferred tax liability and reduced the balance by approximately $200,000.

Although realization is not assured, the Company has concluded that it is more likely than not that the deferred tax assets at December 31, 2009 for which a valuation allowance was determined to be unnecessary will be realized in the ordinary course of operations based on the available positive and negative evidence, primarily the Company s projected earnings. The amount of the net deferred tax assets considered realizable, however, could be reduced in the near term if actual future earnings or income tax rates are lower than estimated, or if there are differences in the timing or amount of future reversals of existing taxable or deductible temporary differences.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At December 31, 2009, the Company has gross net operating loss carry-forwards (NOL) for income tax purposes of approximately $16.0 million and $36.4 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2024 for federal purposes and 2016 for state purposes. Under Section 382 of the Internal Revenue Code, the utilization of the net operating loss carry-forwards can be limited based on changes in the percentage ownership of the Company.

Of the net operating losses available, approximately $1.4 million for federal purposes are attributable to losses incurred by an acquired subsidiary. Such losses are subject to other restrictions on usage including the requirement that they are only available to offset future income of the subsidiary. In addition, the available net operating losses do not include any amounts generated by the acquired subsidiary prior to the acquisition date due to substantial uncertainty regarding the Company s ability to realize the benefit in the future.

The Company recognizes excess tax benefits associated with the exercise of stock options directly to stockholders equity only when realized. Accordingly, deferred tax assets are not recognized for NOL resulting from excess tax benefits. As of December 31, 2009, deferred tax assets do not include approximately $6.9 million of these excess tax benefits from employee stock option exercises that are a component of the Company s net operating loss carry forwards. Accordingly, additional paid-in-capital will be increased up to an additional $6.9 million if and when such excess tax benefits are realized. During 2009, approximately $2.2 million related to net excess tax benefits were realized.

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

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

	Total (in thousands)
Balance at December 31, 2008	$ 839
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	
Reductions for tax positions of prior years	
Settlements	
Balance at December 31, 2009	$ 839

Included in the unrecognized tax benefits of $0.8 million at December 31, 2009 was $0.8 million of tax benefits that, if recognized, would reduce our annual effective tax rate.

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

As of December 31, 2009 and 2008, the Company had recorded a $138,000 and $66,000 accrual for interest and penalties on unrecognized tax benefits, respectively. Interest expenses of $72,000, $66,000 and $0 were recognized in the years ended December 31, 2009, 2008 and 2007, respectively. The Company does not expect any significant decreases to its unrecognized tax benefit within the next 12 months.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years before 2005; state and local income tax examinations before 2004; and foreign income tax examinations before 2004. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carry forward amount. The Company is not currently under Internal Revenue Service (IRS) tax examination. The Company is not currently under examination by any state, local or foreign jurisdictions.

3. Acquisitions of Businesses

2007 Acquisitions

In February 2007, the Company purchased the assets of HurryDate, a leading online personals and singles events company. Of the $4.3 million cash consideration paid, $490,000 was assigned to member databases and is being amortized over three years, $50,000 was assigned to subscriber databases and was amortized over five months, $800,000 was assigned to developed software which is being amortized over five years, $360,000 was assigned to domain names which are not subject to amortization and the remainder was assigned to goodwill. In 2008 the Company impaired the goodwill balance associated with HurryDate. In 2009, the Company paid the final HurryDate earn-out payments of $1.4 million and expensed the payment as impairment expense. The impairment is deductible for tax purposes.

2008 Acquisitions

In December 2008, the Company acquired certain digital media assets and liabilities of a company for total consideration of $1.1 million. Of the $1.1 million consideration, $50,000 was assigned to indefinite life domain names and the remaining amount was assigned to developed software, to be amortized over 5 years. These acquired assets expanded and enhanced our current product offerings.

4. Property and Equipment

Property and equipment consists of the following:

	As of December 31,	
	2009	**2008**
	(in thousands)	
Computer equipment	$ 5,200	$ 4,711
Computer software	4,924	6,934
Leasehold Improvements	1,360	1,545
Furniture, fixtures and equipment	692	691
	12,176	13,881
Less: Accumulated depreciation	(9,899)	(12,196)
	$ 2,277	$ 1,685

Depreciation expense, for the years ended December 31, 2009 and 2008, was $873,000 and $867,000, respectively, and is calculated on the straight-line basis over three years.

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Goodwill and Other Intangible Assets

Jewish Networks and Other Affinity Networks are the only operating units with goodwill balances. Jewish Networks goodwill balance at December 31, 2009 and 2008 was $6.8 million. Other Affinity Networks goodwill balance at December 31, 2009 and 2008 was $11.2 million and $1.9 million, respectively. The following table shows the activity and balances related to goodwill from January 1, 2008 to December 31, 2009 (in thousands):

	Gross goodwill	Accumulated impairments	Net goodwill
Balance at January 1, 2008	$ 20,252	$ (1,894)(1)	$ 18,358
Acquisitions	770(2)		770
Impairment		(1,235)(3)	(1,235)
Foreign currency	71(4)		71
Balance at December 31, 2008	$ 21,093	$ (3,129)	$ 17,964
Acquisitions	1,355(2)		1,355
Impairment		(10,605)(5)	(10,605)
Foreign currency	44(4)		44
Balance at December 31, 2009	$ 22,492	$ (13,734)	$ 8,758

(1) Represents the goodwill impairment associated with our General Market Networks reporting unit.

(2) Represents earn-out payments for the HurryDate reporting unit.

(3) Represents the goodwill impairment of approximately $1.2 million related to the HurryDate reporting unit.

(4) Represents foreign currency translation adjustments related to the Jewish Networks reporting unit.

(5) Represent the goodwill impairment of approximately $9.3 million and $1.4 million related to the Other Affinity and HurryDate reporting units, respectively.

In 2009, the Company performed our annual impairment analysis and determined the fair value of each reporting unit and compared it to the carrying amount of the reporting unit. Based upon several valuation assumptions, including lower expected performance and lower industry multiples, the analysis concluded that the carrying value of the Other Affinity Networks business was higher than its estimated fair value. As a result, the Company performed the second step under the guidance to assess the fair value of the assets and liabilities of Other Affinity Networks. The analysis resulted in impairment to goodwill and domain names of $9.3 and $1.3 million, respectively. In 2009, the Company paid the final $1.4 million in earn-out payments for the HurryDate business. Since there was no significant improvement in the HurryDate business in 2009, the earn-out payments were recorded as impairment expense based on the goodwill impairment analysis done in 2009 and 2008. There were no additional impairments as a result of the assessment.

In 2008, the Company performed its annual valuation and concluded that a sustained decline in HurryDate s speed dating business had reduced projected cash flows below the carrying amount of the reporting unit. As such, the Company impaired the entire amount of HurryDate s Goodwill of $1.2 million as impairment expenses. No other impairment charges resulted from this evaluation since the fair value of each reporting unit exceeded the carrying amount.

Goodwill of $8.8 million as of December 31, 2009 and $18.0 million as of December 31, 2008 is mainly related to the purchase of Pointmatch in January of 2004, MingleMatch, Inc. in May 2005, LDSSingles in May 2006 and HurryDate in February 2007. Finite-lived intangible assets consist of purchased databases and technologies, and

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

are amortized over the expected periods of benefits (three years for member databases, three months for subscriber databases and five years for technologies). Indefinite-lived intangible assets consist of purchased domain names are not amortized. Intangible assets consist of the following:

	As of December 31, 2009		As of December 31, 2008	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
	(in thousands)			
Member databases	$ 3,448	$ 3,373	$ 3,448	$ 3,194
Subscriber databases	713	713	713	713
Purchased technologies	2,332	1,222	2,570	738
Domain names	2,401		3,664	
	$ 8,894	$ 5,308	$ 10,395	$ 4,645

Amortization expense for finite-lived intangible assets for the year ended December 31, 2009 and 2008 was $663,000 and $787,000, respectively. Amortization expense is expected to be $421,000 for the year ending December 31, 2010, and $370,000, $211,000 and $182,000 in 2011, 2012 and 2013 respectively.

6. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31, 2009	December 31, 2008
	(in thousands)	
Advertising	$ 1,036	$ 848
Loss contingencies		500
Taxes payable	150	338
Accrued compensation	1,710	1,450
Other accrued liabilities	1,336	1,694
Total	$ 4,232	$ 4,830

7. Income on Possession of Assets

In the year ended December 31, 2009, the Company became the record title owner of real property purchased in a sheriff s sale to partially satisfy the Company s outstanding judgment against Will Knedlik. On February 1, 2010, the Company entered into a purchase agreement to sell such real property. The Company anticipates closing the transaction in the third quarter of 2010, however, the sale is subject to a number of contingencies. The Company recorded other income of $1.5 million in Interest (income) and other expenses, net on the Consolidated Statements of Operations and recorded the asset as Deposits and Other Assets on the Consolidated Balance Sheets.

8. Notes Payable

Revolving Credit Facility

In February 2008, the Company and its wholly-owned subsidiary, Spark Networks Limited, as borrower, entered into an agreement (the Initial Agreement) with Bank of America for a $30.0 million revolving credit facility, which was amended to $25.0 million on September 29, 2009 (the Amended Agreement).

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Amended Agreement, among other things, increases the per annum interest rate under the Agreement, which is based upon a financial leverage ratio of less than 1.00, 1.00 to 1.49 and 1.50 and greater. The corresponding interest rates on LIBOR based borrowings are increased to LIBOR plus 1.75%, 2.00% and 2.50%, respectively. In the event the Company elects to borrow under a base rate loan, the corresponding interest rates are increased to the prime rate plus, 0.75%, 1.00% and 1.50%, respectively. Under the Amended Agreement, the Company pays a 0.250% to 0.375% per annum commitment fee on all funds not utilized under the facility, measured on a daily basis.

The Amended Agreement requires the Company to maintain a consolidated leverage ratio at any time during any period of four fiscal quarters of no greater than 2.00 to 1.00 for quarters through December 31, 2009 and 1.50 to 1.00 for quarters on and after March 31, 2010, and a consolidated adjusted EBITDA of $9 million for the quarters ending September 30, 2009 through December 31, 2009 and $8 million for the quarters ending on and after March 31, 2010. In addition, the Amended Agreement requires the Company to maintain a fixed charge coverage ratio for each period of four consecutive fiscal quarters of no less than 1.25 to 1.00 through the quarter ending September 30, 2009 and 1.50 to 1.00 for the quarters ending on or after December 31, 2009.

The Company was compliant with the Amended Agreement s customary affirmative and negative covenants, as of December 31, 2009.

At December 31, 2009, there was no outstanding amount under the Amended Agreement. In connection with the amendment in September 2009, the Company paid deferred financing costs of approximately $21,000. In connection with the Initial Agreement, the Company paid deferred financing costs of approximately $446,000. Costs associated with both the Initial and the Amended Agreements were included in other current assets and deposits and other assets. In the third quarter of 2009, the Company wrote off $36,000 of the remaining deferred financing costs associated with the Initial Agreement, reflecting a $5.0 million reduction in the revolving credit facility. The remaining deferred financing costs are amortized to interest expense in the Consolidated Statements of Operations over the full term of the Amended Agreement. Amortization expense for the deferred financing costs for the year ended December 31, 2009 and December 31, 2008 were $148,000 and $136,000, respectively.

9. Stockholders Equity

Stock Repurchases

The Company did not repurchase any stock in 2009. For the years ended December 31, 2008 and 2007, the Company repurchased 5.6 million and 5.4 million shares of common stock, respectively, at weighted average prices of $3.70 and $4.35, respectively. All stock repurchased has been retired.

Employee Equity Incentive Plans

As of July 9, 2007, pursuant to the completion of the Scheme of Arrangement, the Company adopted the Spark Networks, Inc. 2007 Omnibus Incentive Plan (the 2007 Plan) authorizing and reserving 2.5 million options. Prior to the Company s incorporation and Scheme of Arrangement, Spark Networks plc had two share Option Plans, the MatchNet plc 2000 Executive Share Option Plan (the 2000 Plan) and Spark Networks plc 2004 Share Option Plan (the 2004 Plan). As of July 9, 2007, no further options will be granted under the 2000 Plan or the 2004 Plan; however, pursuant to the provisions of the 2004 Plan and 2000 Plan, all outstanding options previously granted under such plans continue in full force and effect.

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

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

As of December 31, 2009, total unrecognized compensation cost related to non-vested stock options was $3.2 million. This cost is expected to be recognized over a weighted-average period of 3 years. The following table describes option activity for the years ended December 31, 2009, 2008 and 2007:

	Years Ended December 31,		
	2009	2008	2007
Granted, weighted average fair value per share	$ 0.79	$ 1.71	$ 2.23
Exercised, weighted average intrinsic value per share	$ 1.63	$ 1.24	$ 0.83
Aggregate intrinsic value of options outstanding and exercisable (in thousands)	$ 0	$ 73	$ 335

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

	Number of Shares	Weighted Average Price per Share
Outstanding at December 31, 2007	4,317	$ 5.98
Granted	201	4.24
Exercised	(129)	4.60
Expired	(580)	7.60
Forfeited	(166)	6.82
Outstanding at December 31, 2008	3,643	5.62
Granted	3,200	2.98
Exercised	(40)	0.80
Expired	(3,260)	5.69
Forfeited	(156)	3.62
Outstanding at December 31, 2009	3,387	$ 3.28

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Option Range Summary

As of December 31, 2009

Range of Exercise Prices	Options Outstanding Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Options Exercisable Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price
$3.91 - $8.60	279	4	$ 5.30	186	4	$ 5.31
$3.00	2,951	8	$ 3.00	155	6	$ 3.00
$2.18 - $2.99	157	7	$ 2.54	12	6	$ 2.96
	3,387	8	$ 3.28	353	5	$ 4.22

As of December 31, 2008

Range of Exercise Prices	Options Outstanding Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Options Exercisable Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price
$5.74 - $12.41	1,269	4	$ 6.77	822	5	$ 6.99
$5.45 - $5.68	1,465	7	$ 5.48	654	4	$ 5.48
$0.73 - $5.44	909	6	$ 4.25	272	7	$ 3.97
	3,643	6	$ 5.62	1,748	5	$ 5.96

Options granted prior to 2006, were priced in foreign currency, weighted average price per share calculations are impacted by foreign currency exchange fluctuations.

Significant Modifications

In 2009, the Company offered to re-price options for certain employees. These employees could surrender their existing options in exchange for a like number of options with a new grant date, a lower exercise price, a lower number of vested options and a modified vesting schedule. The exchange of options was treated as a synthetic re-pricing, which includes a cancellation and replacement of equity instruments. The estimated incremental expense is approximately $1 million and will be recognized over the four year vesting term of the options.

Stockholder Rights Plan

As of July 9, 2007, the Company adopted a stockholder rights plan in connection with the completion of the Scheme of Arrangement. The rights accompany each share of common stock of the Company and are evidenced by ownership of common stock. The rights are not exercisable except upon the occurrence of certain takeover-related events. Once triggered, the rights would entitle the stockholders, other than a person qualifying as an Acquiring Person pursuant to the rights plan, to purchase additional common stock at a 50% discount to their fair market value. The rights issued under the Rights Plan may be redeemed by the board of directors at a nominal redemption price of $0.001 per right, and the board of directors may amend the rights in any respect until the rights are triggered.

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Employee Benefit Plan

The Company has a defined contribution plan under Section 401(k) of the Internal Revenue Code covering all full-time employees, and providing for matching contributions by the Company, as defined in the plan. Participants in the plan may direct the investment of their personal accounts to a choice of mutual funds consisting of various portfolios of stocks, bonds, or cash instruments. Contributions made by the Company to the plan for the years ended December 31, 2009, 2008 and 2007 were approximately $343,000, $342,000 and $249,000, respectively.

11. Segment Information

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for making operating decisions and assessing performance. The Company s financial reporting includes detailed data on four separate reportable segments which were principally determined based on similarity of economic characteristics. During the third quarter of 2007, the Company changed its financial reporting to include data on four newly-defined operating segments: Jewish Networks, which consists of JDate.com, JDate.co.il, Cupid.co.il and their respective co-branded and private label websites; General Market Networks, which consists of AmericanSingles.com and Date.ca, which were both rebranded as Spark.com in December of 2009 and Date.co.uk which was rebranded as Spark.com in February 2010 and their respective co-branded and private label websites; Other Affinity Networks, which consists of the Company s Provo, Utah-based properties which are primarily made up of sites targeted towards various religious, ethnic, geographic and special interest groups; and Offline & Other Businesses, which consists of revenue generated from offline activities, HurryDate events and subscriptions, and other websites and businesses. The change was a result of the change to the Company s overall revenue mix and how management reviews information to assess financial performance. The Company believes the new segments will provide investors with a more accurate picture of the performance of the business. Prior period segment disclosures were revised to conform to the revised segment presentation:

	Years Ended December 31,		
	2009	2008 (in thousands)	2007
Revenue			
Jewish Networks	$ 28,842	$ 33,740	$ 33,624
Other Affinity Networks	12,771	13,749	13,314
General Market Networks	2,692	7,762	15,707
Offline and Other Businesses	1,083	2,015	2,573
Total Revenue	$ 45,388	$ 57,266	$ 65,218
Direct Marketing Expenses			
Jewish Networks	$ 2,346	$ 2,519	$ 3,281
Other Affinity Networks	8,502	7,875	7,828
General Market Networks	676	3,488	8,462
Offline and Other Businesses	541	1,128	1,524
Total Direct Marketing Expenses	$ 12,065	$ 15,010	$ 21,095
Unallocated Operating Expense	37,347	32,936	40,492
Operating Income (Loss)	**$ (4,024)**	**$ 9,320**	**$ 3,631**

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Due to the Company s integrated business structure, cost and expenses, other than direct marketing expenses, are not allocated to the individual reporting segments. As such, the Company does not measure operating profit or loss by segment for internal reporting purposes. Assets are not allocated to the different business segments for internal reporting purposes.

The Company operates several international Web sites, however, many of them are operated and managed by the Company s U.S. operations. Foreign revenue represent sales generated outside the U.S. where the Company has its principal operations. Revenue and identifiable assets by, excluding deferred tax assets, by geographical area are as follows:

	Year Ended December 31, 2009	2008
	(in thousands)	
Revenue		
United States	$ 41,413	$ 52,408
Israel	3,975	4,858
Total	**$ 45,388**	**$ 57,266**
Non-Current Assets		
United States	$ 9,898	$ 19,210
Israel	6,589	6,590
Total	**$ 16,487**	**$ 25,800**

12. Commitments and Contingencies

Operating Leases

The Company leases its office facilities under operating lease agreements effective through April 2012, providing for annual minimum lease payments as follows (amounts in thousands):

Year Ending	
2010	$ 1,220
2011	861
2012	96
Total	$ 2,177

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

The Company recognized rent expense under operating leases of $1.3 million, $1.3 million and $1.5 million for the years ended December 31, 2009, 2008 and 2007 respectively.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Commitments and Obligations

The Company has other commitments and obligations consisting of legal settlements and contracts with software licensing, communications, computer hosting and marketing service providers. These amounts totaled $272,000 for less than one year and $134,000 between one and three years. Contracts with other service providers are for 30 day terms or less.

Year Ending (amounts in thousands)	
2010	$ 272
2011	134
Total	$ 406

Legal Proceedings

Spark Network Services, Inc. v. Match.com, LP, eHarmony.com, Inc., Various, Inc., True Beginnings, LLC, Perfect Match LLC, Plentyoffish Media, Inc. and Spark Networks, Inc.

On January 30, 2007, Spark Network Services, Inc. initiated an action in the United States District Court for the Northern District of Illinois, Eastern Division. On December 4, 2007, Plaintiff, Spark Networks Services, filed an amended complaint, adding Spark Networks, Inc. as a defendant. Spark Networks Services asserted in an Amended Complaint that Spark Networks, Inc. infringed certain claims of U.S. Patent No. 6,272,467 by allegedly using the 467 patent s claimed methods for automated two way matching of selected traits and preferences for determining the users compatibility. Spark Networks, Inc. filed an Answer in which it denied infringing the 467 patent and asserted that the 467 patent is invalid. On January 7, 2008, defendants Match.com and eHarmony.com filed a motion asking the Court to stay the litigation pending the outcome of a reexamination proceeding that had been requested in the U.S. Patent Office with respect to the 467 patent. The reexamination request alleges that the asserted (and other) claims of the 467 patent are invalid based on certain prior art. On January 28, 2008, the reexamination request was granted by the Patent Office. The litigation was then stayed on February 21, 2008. The parties settled the case on March 16, 2010 and on March 22, 2010, a stipulated order to dismiss the case was filed with the court.

ISYSTEMS v. Spark Networks, Inc. et al.

On July 11, 2008, ISYSTEMS initiated a lawsuit against Spark Networks, Inc., Spark Networks Limited and other parties in the United States District Court, Northern District of Texas, Dallas Division. The lawsuit was filed in response to an arbitration award ordering the transfer of the domain name, JDATE.NET, to Spark Networks Limited from ISYSTEMS. Spark Networks was apprised of the lawsuit after ISYSTEMS unsuccessfully attempted to utilize the filing of the lawsuit to prevent the domain transfer to Spark Networks Limited. On December 1, 2008, Spark Networks filed a Motion to Dismiss the Complaint, or, alternatively, for Summary Judgment. On June 10, 2009, the Court granted our motion and dismissed the case with prejudice. On June 22, 2009, ISYSTEMS filed a motion to vacate the order dismissing the action and requesting leave to amend its complaint. On October 26, 2009, the Court granted ISYSTEMS motion. ISYSTEMS filed its Amended Complaint on November 25, 2009. On January 19, 2010, Spark Networks filed a Motion to Dismiss the Amended Complaint, or Alternatively, for Summary Judgment. A trial date has been tentatively set for January 2011.

Ness Interactive v. Spark Networks Limited

On January 22, 2010, Spark Networks Limited was served with a complaint from Ness Interactive alleging that Spark Networks engaged in unfair competition by bidding on certain online advertising keywords in France. An initial hearing has been scheduled for April 16, 2010.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

L.I.S.T. Incorporated v. Spark Networks, Inc. et al

On March 11, 2010, L.I.S.T. Incorporated initiated a class action lawsuit against Spark Networks, Inc., Adam S. Berger, Jonathan B. Bulkeley, Benjamin Derhy, Thomas G. Stockham, Michael A. Kumin, Great Hill Equity Partners III, LP and Great Hill Partners, LLC in the Court of Chancery of the State of Delaware, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own.

Mike Shaffer v. Spark Networks, Inc. et al

On March 24, 2010, Mike Shaffer initiated a class action lawsuit against Adam Berger, Michael Kumin, Jonathan Bulkeley, Benjamin Derhy, Thomas G. Stockham, Spark Networks, Inc., Great Hill Partners, LLC and Great Hill Equity Partners III, LP in the Superior Court of California, County of Los Angeles, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own.

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

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

13. Related Party Transactions

The Company had entered into a confidentiality agreement dated October 14, 2005 with Great Hill Equity Partners II (the Stockholder) that contained a provision (the Standstill Provision) pursuant to which the Stockholder agreed not to, among other things, directly or indirectly acquire, offer to acquire, or propose to acquire more than 2% of any class of the Company s securities or rights to acquire more than 2% of any class of the Company s securities for a period of one year from the date of the confidentiality agreement without the Company s prior written consent. On December 1, 2005, the Company and the Stockholder entered into a standstill agreement (the Standstill Agreement) pursuant to which the Company waived the Standstill Provision and the Stockholder agreed that its ability to increase its beneficial ownership of the Company s securities would be subject to the terms and conditions of the Standstill Agreement, which has a term of five years unless terminated earlier by agreement of the parties. Pursuant to the Standstill Agreement, Great Hill Equity Partners II agreed that it would not, other than through bona fide all cash offers made in accordance with the terms of the Standstill Agreement to all of the Company s stockholders or share repurchases or other actions initiated by the Company, acquire or seek to acquire beneficial ownership of any of our voting securities (or rights to acquire any class of our securities or any subsidiary thereof) or participate in any tender, takeover or exchange offer or other business combination, or any recapitalization, restructuring, dissolution or other extraordinary transaction if (1) prior to giving effect thereto, the Great Hill group beneficially owns less than 60% of Total Voting Power and (2) after giving effect, the Great Hill Group would beneficially own more than 29.9% of Total Voting Power.

On March 2, 2010, the Company granted a partial waiver of the Standstill Agreement to the extent necessary to allow the special committee of the board of directors to receive, discuss and negotiate a proposal by the Great Hill Group to purchase all of the outstanding shares of common stock of the Company not owned by the Great Hill Group, at a cash purchase price of $3.10 per share. The waiver will automatically (but not retroactively) terminate if the Company, at the direction of the board of directors or the special committee, decides to discontinue discussions with the Great Hill Group.

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Quarterly Results of Operations (unaudited)

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

	Three Months Ended (1)							
(in thousands, except per share amount)	Dec. 31, 2009	Sept. 30, 2009	June 30, 2009	March 31, 2009	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008	March 31, 2008
Consolidated Statement of Operations Data:								
Revenue	$ 11,056	$ 11,058	$ 11,242	$ 12,032	$ 13,216	$ 14,041	$ 14,987	$ 15,022
Cost of revenue	3,953	3,849	3,755	3,650	4,309	4,337	5,003	5,066
Sales and marketing	904	845	837	921	971	1,082	1,128	1,053
Customer service	400	450	437	545	511	599	581	628
Technical operations	376	342	393	393	421	491	508	497
Development	674	899	1,055	1,267	1,005	1,134	1,103	1,221
General and administrative	2,390	2,311	2,453	2,778	3,180	3,263	3,341	3,506
Depreciation	236	236	195	206	218	226	178	245
Amortization	165	127	187	184	129	107	222	329
Impairment of goodwill and other assets	11,119			880	1,235	119		
Total operating expenses	20,217	9,059	9,312	10,824	11,979	11,358	12,064	12,545
Income (loss) from operations	(9,161)	1,999	1,930	1,208	1,237	2,683	2,923	2,477
Income (loss) before income taxes	(9,499)	2,043	3,815	716	721	2,534	3,147	2,811
Provision for income taxes	109	1,036	1,928	405	885	789	1,506	1,245
Net income (loss)	$ (9,608)	$ 1,007	$ 1,887	$ 311	$ (164)	$ 1,745	$ 1,641	$ 1,566
Basic and diluted net income (loss) per share	$ (0.47)	$ 0.05	$ 0.09	$ 0.02	$ (0.01)	$ 0.08	$ 0.07	$ 0.06
Shares used in computation of basic net income (loss) per share	20,582	20,582	20,568	20,548	21,300	22,751	24,555	26,004
Shares used in computation of diluted net income (loss) per share	20,582	20,582	20,574	20,563	21,300	22,770	24,575	26,027

(1) Prior period information has been reclassified to current period presentation

15. Subsequent Events (unaudited)

On January 22, 2010, Spark Networks Limited was served with a complaint from Ness Interactive alleging that Spark Networks engaged in unfair competition by bidding on certain online advertising keywords in France. An initial hearing is scheduled for April 16, 2010.

On March 2, 2010, the Company received a proposal by Great Hill Partners III, LP (Great Hill) to purchase all of the outstanding shares of common stock of the Company not owned by Great Hill at a cash purchase price of $3.10 per share. A Special Committee of independent directors has retained a financial advisor and is reviewing and evaluating the proposal and any other potential transactions and strategic alternatives. The Special

Table of Contents

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Committee will recommend to Spark Networks board of directors whether to approve or decline the proposal and any other potential transactions and strategic alternatives. The Company also granted a partial waiver of its standstill agreement with Great Hill to the extent necessary to allow the Special Committee to receive, discuss and negotiate the proposal with Great Hill; however the waiver will automatically (but not retroactively) terminate if the Company, at the direction of the board of directors or the Special Committee, decides to discontinue discussions with Great Hill.

On March 11, 2010, L.I.S.T. Incorporated initiated a class action lawsuit against Spark Networks, Inc., Adam S. Berger, Jonathan B. Bulkeley, Benjamin Derhy, Thomas G. Stockham, Michael A. Kumin, Great Hill Equity Partners III, LP and Great Hill Partners, LLC in the Court of Chancery of the State of Delaware, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own.

On March 24, 2010, Mike Shaffer initiated a class action lawsuit against Adam Berger, Michael Kumin, Jonathan Bulkeley, Benjamin Derhy, Thomas G. Stockham, Spark Networks, Inc., Great Hill Partners, LLC and Great Hill Equity Partners III, LP in the Superior Court of California, County of Los Angeles, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own.

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