

SPARK NETWORKS INC  
Form 10-K  
March 31, 2008  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

**▶ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007**

**OR**

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

**COMMISSION FILE NO. 001-32750**

**SPARK NETWORKS, INC.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

**DELAWARE**

*(State or other jurisdiction of  
incorporation or organization)*

**20-8901733**

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

**8383 Wilshire Boulevard, Suite 800, Beverly Hills, California**

*(Address of principal executive offices)*

**90211**

*(Zip Code)*

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

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

<b>Title of Each Class</b>	<b>Name of Each Exchange on which Registered</b>
Common Stock, par value \$0.001 per share	American Stock Exchange

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

**None.**

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

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

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

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

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

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

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

As of June 30, 2007, the aggregate market value of the ordinary shares of Spark Networks plc, the predecessor registrant, held by non-affiliates was approximately \$67,753,029 based on the closing sale price of the ordinary shares in the form of Global Depositary Shares as reported on the Frankfurt Stock Exchange, the predecessor registrant's principal exchange at that time. Ordinary shares held by each officer and director and by each person who owned 10% or more of the outstanding ordinary shares have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The registrant had 25,363,315 outstanding common stock, par value \$0.001 per share, as of March 28, 2008.

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 2008 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.

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*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

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and assumptions described in the Risk Factors section and elsewhere in this 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 growth;

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 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 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. Our SEC filings are also available at the office of the American Stock Exchange.

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For further information on obtaining copies of our public filings at the American Stock Exchange, you should call (212) 306-1000.

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

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**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 the many features on our Web sites, such as detailed profiles, onsite email centers, real-time chat rooms, instant messaging services and offline singles events.

Currently, our key Web sites include JDate.com, AmericanSingles.com, BlackSingles.com and ChristianMingle.com. We also operate several international Web sites and maintain operations in the United States and Israel. Information regarding the geographical source of our revenues 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 to access our searchable database of member profiles and customer service. On the majority 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 also offer discounted subscription rates for members who subscribe for longer periods. Our subscription programs primarily renew automatically for subsequent one-month periods until paying subscribers terminate them.

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 ). As of 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 shares of Spark Networks, Inc., a Delaware corporation and Limited s parent entity, have been traded on 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 ability 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 JDate Brand.*** We believe JDate with its strong brand recognition in the Jewish community 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.

***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,

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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' online personals experiences. Many of the features we offer, such as onsite emails, real-time chat rooms, instant messaging, E-cards, and message boards increase the probability of communication between our members, which we believe increases the number and percentage of members who become or remain paying subscribers. We believe this functionality drives return visits to our Web sites and helps retain paying subscribers who might otherwise consider switching to our competitors' Web sites or not subscribing to any personals Web site.

**Customer Service Focus.** Our multi-lingual call center helps members with such matters as completing personal profiles and choosing photos for their profiles, as well as answering questions about billing and technical issues. 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, 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 unique company in the online personals industry because, in addition to servicing mass markets, 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:

<b>Web Site</b>	<b>Target Audience</b>
<b>Jewish Networks</b>	
JDate.com	Jewish Singles
Cupid.co.il	Jewish singles (Hebrew speakers)
JDate.co.il	Jewish singles (Hebrew speakers)
JDate.fr	Jewish singles (French speakers)
<b>General Market Networks</b>	
American Singles.com	Non-targeted
CollegeLuv.com	College singles
Date.ca	Canadian singles
Date.co.uk	UK singles
<b>Other Affinity Networks</b>	
AdventistSinglesConnection.com	Adventist singles
AsianSinglesConnection.com	Asian singles
BBWPersonalsPlus.com	Big beautiful women and admirers
Black Singles.com	African-American Singles
CanadianPersonals.net	Canadian singles
CatholicMingle.com	Catholic singles

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<b>Web Site</b>	<b>Target Audience</b>
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
PrimeSingles.net	Mature singles
SingleParentsMingle.com	Single parents
<b>Offline and Other Businesses</b>	
HurryDate.com	Rapid dating and offline events
Kizmeet.com	Missed connections

**Web Site Features.** We strive to offer traditional as well as new and different ways for our members to communicate. Examples of ways our members and paying subscribers can communicate include:

*On-Site Email.* We provide all paying subscribers with private message centers, dedicated exclusively to communications with other paying subscribers. 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 afford a paying subscriber the ability to control future messages from specific paying subscribers.

*Hot Lists and Favorites.* Among the most popular features on our Web sites, Hot Lists enable paying subscribers 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. Paying subscribers can group their favorites into customized folders and add their own notes, including details included in a member's profile.

*Message Boards.* Another popular feature, Message Boards enable paying subscribers to communicate in a group environment with suggested topics for discussion.

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

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

*Click!* Our patented Click! feature connects members who think they would be compatible with each other. A member simply clicks yes, no or maybe in another member's profile. When two members click yes to 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. Approximately 4% of our revenues for the year ended December 31, 2007 were generated from travel and events.





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### **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, implementing advertising sales on select Web sites and expanding our offline events business.

***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 become paying subscribers. We will also continue to inform members of new features and functions with the goal of increasing the number of visitors to our Web sites who become paying subscribers.

*Improved technology.* 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 our technology and the quality and relevance of our search results to provide fast, relevant suggestions.

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

***Extend into new affinity-focused markets.*** We constantly evaluate new opportunities in an attempt to identify new affinity-focused markets into which we may expand either organically or through acquisition. Our large base of members provides us with a significant amount of 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. We intend to target affinity markets we believe are receptive to paid online personals and are large enough to attain a critical mass of members and paying subscribers.

***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.

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***Expand offline presence.*** We intend to expand upon our offline events offerings and offer a value proposition to our subscribers that is unique in the dating world. Our network provides increased distribution and promotion for our HurryDate and Schmooz-A-Palooza events offerings. In addition, we plan to expand JDate's existing offline offering, which currently includes travel, parties and other activities, to include speed dating events. It is also our intention to offer our events to other communities across our network.

## **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 on Web portals and other specialized sites. We also rely on commercial search listings and direct email campaigns to attract potential members and paying subscribers, and utilize 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.

In addition to our current online marketing efforts, we supplement our online marketing by employing a variety of offline marketing and business development activities. These include print and outdoor advertising, public relations, event sponsorship and promotional alliances. We believe that 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 numbers of our members and paying subscribers.

## **Customer Service**

Our team of customer service representatives helps members with matters such as completing personal essays and choosing photos for their profiles, as well as answering questions about billing and technical issues. Customer service representatives receive ongoing training in an effort to better personalize the experience for members and paying subscribers who call in and to capitalize on upselling opportunities.

## **Technology**

Throughout the year projects such as Photo Gallery, SMS alerts and Automatic Log-in were successfully deployed using a mix of our proprietary technologies. Since feature and functionality development is an important element of our strategy, we plan to expand our technology team. In addition to our new products, this group of employees maintains 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 Orem, 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, JDate, AmericanSingles and BlackSingles.com are some of our trademarks, whether registered or not, in the United States and several other countries. AmericanSingles, 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

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trademarks are perpetual as long as we use them and renew them periodically. We also have a number of other registered and unregistered trademarks. In addition, 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.

### **Competition**

We operate in a highly competitive environment with minimal barriers to entry. We believe that 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 also numerous other companies offering online personals services that compete with us, but are smaller than we are in terms of paying subscribers and annual revenue generation.

### **Employees**

As of December 31, 2007, we had 176 full-time 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**

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

Although we were profitable in 2007 and 2006, we have historically generated significant operating losses. As of December 31, 2007, we had an accumulated deficit of approximately \$29.5 million. We had net income of approximately \$9.0 and \$6.6 million for the years ended December 31, 2007 and 2006 respectively and a loss of \$1.4 million for the fiscal year ended December 31, 2005. If our revenues do not grow at a substantially faster rate than our operating expenses, or if our operating expenses are higher than we anticipate, we may not be profitable and we may incur additional losses, which could be significant.

#### **Our limited operating history and relatively new business model in an emerging and rapidly evolving market make it difficult to evaluate our future prospects.**

We derive nearly all of our net revenues from online subscription fees for our services, which is an early-stage business model for us that has undergone, and continues to experience, rapid and dramatic changes. As a result, we have very little operating history for you to evaluate in assessing our future prospects. You must consider our business and prospects in light of the risks and difficulties we will encounter as an early-stage company in a new

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and rapidly evolving market. Our performance will depend on the continued acceptance and evolution of online personal services and other factors addressed herein. We may not be able to effectively assess or address the evolving risks and difficulties present in the market, which could threaten our capacity to continue operations successfully in the future.

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

In general, the costs of online advertising have recently increased substantially and we expect those costs to continue to increase as long as the demand for online advertising remains robust. 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 anticipated 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.

**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,



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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.

### **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.**

One of our strategies is to expand into new vertical affinity markets to increase our revenue base. We view vertical affinity markets as identifiable groups of people who share common interests and the desire to meet companions or dates with similar interests, backgrounds or traits. Our planned expansion into such vertical affinity markets will occupy our management's time and attention and will require us to invest significant capital resources. The results of our 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. Historically, 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, ecards, personality profiles, and mobile content delivery. Introducing new technologies into our systems involves numerous





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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 2006 and 2007 we introduced a number of new Web sites and features, and we anticipate the introduction of additional Web sites and features in 2008 and 2009. 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 intend 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.

**We may have potential liability under California state and federal securities laws with respect to the grant of share options to certain of our employees, directors and consultants and the exercise of these options.**

Under our 2000 Executive Share Option Scheme ( 2000 Option Scheme ), we granted options to purchase ordinary shares of our predecessor registrant (Spark Networks plc) to certain of our employees, directors and consultants. California state securities laws generally require qualification for the offer and sale of securities subject to California law. Under California law, the grant of an option constitutes a sale of the underlying shares at the time of the option grant and not at the exercise of the option. Our option grants were not qualified and may not have been exempt from qualification under California state securities laws. As a result, we may have potential liability to those employees, directors and consultants to whom we granted options under the 2000 Option Scheme. In order to address that issue, we may elect to make a rescission offer to the holders of outstanding options under the 2000 Option Scheme to give them the opportunity to rescind the grant of their options.

As of December 31, 2007, assuming every eligible recipient of options were to accept a rescission offer, we estimate the total cost to us to complete the rescission would be approximately \$280,000 including statutory interest at 7% per annum. These amounts reflect the costs of offering to rescind the issuance of the outstanding options by paying an amount equal to 20% of the aggregate exercise price for the entire option.

In addition, issuances of securities upon exercise of options granted under our 2000 Option Scheme may not have been exempt from registration and qualification under California state securities laws as a result of the option grants themselves and also may not have been exempt from registration under federal securities laws. Federal securities laws prohibit the offer or sale of securities unless the sales are registered or exempt from registration. The issuances of ordinary shares, or after our Scheme of Arrangement, common stock, upon the exercise of our options were not registered and may not have been exempt from registration under California state and federal securities laws. As a result, we may have potential liability to those employees, directors and consultants to whom we issued securities upon the exercise of these options. In order to address that issue, we may elect to make a rescission offer to those persons who exercised all, or a portion, of those options and continue to hold the shares issued upon exercise, to give them the opportunity to rescind the issuance of those shares ( Option Shares ).

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As of December 31, 2007, assuming every eligible person that continues to hold the securities issued upon exercise of options granted under the 2000 Option Scheme were to accept a rescission offer, we estimate the total cost to us to complete the rescission would be approximately \$7.5 million including statutory interest at 7% per annum, accrued since the date of exercise of the options. These amounts are calculated by reference to the acquisition price of the Option Shares.

A holder could argue that this process does not represent an adequate remedy for issuance of an option and securities issued upon exercise of an option in violation of California state or federal securities laws and, if a court were to impose a greater remedy, our financial exposure could be greater. In addition, it is the Securities and Exchange Commission's position that a rescission offer will not bar or extinguish any liability under the Securities Act of 1933 with respect to these options and shares, nor will a rescission offer extinguish a holder's right to rescind the issuance of securities that were not registered or exempt from the registration requirements under the Securities Act of 1933. If any or all of the holders reject or fail to respond to our rescission offer, the holders will keep their options and securities and we may continue to be liable under federal and California state securities laws for up to an amount equal to the value of the options and securities granted or issued plus any statutory interest we may be required to pay. Further, claims or actions based on fraud may not be waived or barred pursuant to a rescission offer and there can be no assurance that we will be able to enforce any waivers that we may receive in connection with the rescission offer in order to bar such claims or other causes of action until the applicable statute of limitations has run. In addition, despite a rescission offer, whether accepted or not, if it is determined that we offered securities without properly registering them under federal or state law, or securing an exemption from registration, regulators could impose monetary fines or other sanctions as provided under these laws.

We have terminated and no longer grant options under our 2000 Option Scheme, but options previously granted under the 2000 Option Scheme remain in full force and effect. We filed a registration statement on Form S-8 covering the issuance of future shares upon exercise of presently unexercised options under the 2000 Option Scheme. However, none of the shares (including shares underlying unexercised options) registered on the Form S-8 will be eligible for resale if they are tendered as part of the rescission offer.

### **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. We have recently recruited many of our directors, executive officers and other key management talent, some of which have limited or no experience in the online personals industry. For example, Adam S. Berger, a director of our company, joined the management team as our Chief Executive Officer in February 2007. Our Chief Information Officer started with us in June 2007 and our new Chief Financial Officer started with us in December 2007. Because members of our executive management have only worked together as a team for a limited time, there are inherent risks in the management of our company with respect to decision-making, business direction, product development and strategic relationships. In the event that the members of our executive management team are unable to work well together or agree on operating principles, business direction or business transactions or are unable to provide cohesive leadership, our business could be harmed and one or more of those individuals may discontinue their service to our company, and we would be forced to find a suitable replacement. The loss of any of our management or key personnel could seriously harm our business. Furthermore, we have recently experienced significant turnover on our board of directors. During 2007, five board members resigned and our new board member, Thomas Stockham, was appointed. We currently have five members serving on our board of directors.

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

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provided by our option grants or by future arrangements, such as cash bonuses, may not be as effective as they have been in the past. If we do not succeed in attracting necessary personnel or retaining and motivating existing personnel, we may be unable to grow effectively.

### **Our growth rates may decline and our operating margins could deteriorate.**

Our revenue declined over the last year and the growth of the online personals industry has slowed. A February 2008 report by Jupiter Research found that the online personals industry grew 13% in 2007 as compared to 77% in 2003. It is possible that our operating margins will deteriorate if revenue growth does not exceed 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 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 currently have adequate disaster recovery systems in place, 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 and the absence of a backup site could exacerbate any such disruption. 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,

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an affiliate generally advertises or promotes our Web site on its Web site, and earns a fee whenever visitors to its Web site click through the advertisement to one of our Web sites and register or subscribe 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.

### **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 email 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 shareholders could lose confidence in our financial reporting, which would harm the value of our shares.**

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports, effectively prevent fraud and operate as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We have, in the past, discovered and may, in the future, discover areas of our internal controls over financial reporting that need improvement. As a U.S. public company, we are subject to the reporting requirements of the Sarbanes-Oxley Act of 2002. We are required to annually assess and report on our internal controls over financial reporting. If we are unable to adequately establish 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.**

In May 2005, we acquired MingleMatch, Inc. and completed an asset purchase of its main competitor, LDSSingles, in May 2006. In February 2007, we purchased the assets of HurryDate, a leading online personals and singles events business. 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

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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 resource 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



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or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names in all countries in which we conduct business. Furthermore, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our existing trademarks and other proprietary rights or those we may seek to acquire. Any such inability to protect ourselves could cause us to lose a significant portion of our members and paying subscribers to our competitors.

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

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 revenues 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 revenues 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, among others:

the demand for, and acceptance of, our online personal services and enhancements to these services;

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the timing and amount of our subscription revenues;

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 shareholders or limit our flexibility in conducting our business activities.**

We currently anticipate that existing cash, cash equivalents and marketable securities 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. 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 shareholders 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;

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

longer payment cycles in some countries;

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

different legal and regulatory restrictions among jurisdictions;

political, social and economic instability;

potentially adverse tax consequences; and

higher costs associated with doing business internationally.

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

Our foreign operations may subject us to currency fluctuations and such fluctuations may adversely affect our financial position and results. However, sales and expenses to date have occurred primarily in the United States. For this reason, we have not engaged in foreign exchange hedging. 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 lack adequate redundant network infrastructure, hardware and software systems supporting our services at an alternate site. 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 prices for the coverage we do get; (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

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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.

**We recently secured a \$30.0 million revolving credit facility, which if fully or partially utilized, could restrict our ability to utilize our operating cash flow for the growth of our business.**

In February 2008, we obtained a \$30.0 million revolving credit facility, upon which we have not yet drawn. If we were to draw upon the facility and we are not able 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 net revenues. If we are unable to meet our obligations as they become due or to comply with various financial covenants contained in the revolving credit facility, this could constitute an event of default.

Our obligations under the credit facility are secured by a lien on substantially all of the assets of Spark Networks 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 the Company operates its 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.

## **Risks Related to Our Industry**

**The percentage of canceling paying subscribers in comparison to other subscription businesses requires that we continuously seek new paying subscribers to maintain or increase our current level of revenue.**

## Edgar Filing: SPARK NETWORKS INC - Form 10-K

Internet users in general, and users of online personals services specifically, freely navigate and switch among a large number of Web sites. Monthly subscriber churn represents the ratio expressed as a percentage of (a) the number of paying subscriber cancellations during the period divided by the average number of paying subscribers during the period and (b) the number of months in the period. The number of 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

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for each month, divided by the number of months. We cannot assure you that our monthly average subscriber churn will remain at consistent levels, and it may increase in the future. This makes it difficult for us to have a stable paying subscriber base and requires that we constantly attract new paying subscribers at a faster rate than subscription terminations to maintain or increase our current level of revenue. If we are unable to attract new paying subscribers on a cost-effective basis, our business will not grow and our profitability will be adversely affected.

### **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 revenues. 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 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 revenues 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

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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 the complaints were dismissed in Illinois and New York and are no longer subject to appeal in these states, the action in California, where the court also dismissed the representative plaintiff's claims in September 2006 finding that he did not suffer any injury or damages, is on appeal. Also, although the Illinois complaint was dismissed, the opinion 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 the pending lawsuit and 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 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.

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**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 revenues or cause our revenues 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 passed such a bill in January 2008 and other state legislatures may still be considering the implementation of such legislation. The New Jersey statute does not take effect until May 2008. The enforcement and 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. Any legislation enacted or restrictions arising from current or future government investigations or policy could dampen the growth in use of the Internet, generally, and decrease 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 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



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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 shares may be volatile, and if an active trading market for our shares does not develop, the price of our shares 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 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 have implemented a share repurchase plan, which, may restrict our funds available for other actions and negatively affect the market price of our securities.**

In the past, we have implemented share repurchase plans and may implement share repurchase plans in the future. In March 2008, our board of directors approved a share repurchase plan pursuant to which we may repurchase, from time to time, our common stock on the American Stock Exchange subject to the requirements of Rules 10b5-1 and 10b-18 under the Securities and Exchange Act of 1934. A share 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. Under the current plan, we are permitted to repurchase up to an aggregate of 1,500,000 shares of common stock. The full implementation of this repurchase plan would 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. Our repurchase plan will also likely result in an increase in the share percentage ownership of 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 shares 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. Our repurchase plan will also reduce the number of shares 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 shareholders 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 28, 2008, Great Hill Investors, LLC, Capital Research Management Company, Moab Capital Partners, LLC and their respective affiliates, beneficially owned approximately, in the aggregate, 52% of our

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outstanding share capital. Great Hill Investors, LLC and its affiliates ( Great Hill ) became our largest shareholder on December 1, 2005 when it purchased an aggregate of 6,000,000 ordinary shares in four privately negotiated transactions. Of the 6,000,000 shares purchased, (i) 2,500,000 shares were purchased from the two co-founders of our company and former co-Chairmen of our board of directors, (ii) 1,500,000 shares were purchased from Criterion Capital Management LLC and (iii) 2,000,000 shares were purchased from affiliates of Tiger Global Management L.L.C. Great Hill has since acquired an additional 3,085,000 shares and held an aggregate of 9,085,000 shares as of March 28, 2008. These shareholders possess significant influence over our company. Such share 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 share ownership may have the effect of control over substantially all matters requiring shareholder 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 shareholders, as discussed below, we do not expect that these shareholders will vote together as a group.

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

As of March 28, 2008, Great Hill beneficially owned 9,085,000 shares of our company, or approximately 36% of our outstanding shares, and has voting control of an aggregate of approximately 45% 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 each of the co-founders, affiliates of Tiger Global Management, and Criterion Capital Management (collectively, the Selling Shareholders ). Pursuant to the terms of the share purchase agreements with each of the Selling Shareholders, for so long as Great Hill collectively owns: (i) in the case of the share purchase agreements entered into with the co-founders, at least 10% of the outstanding shares; and (ii) in the case of the share purchase agreements entered into with Tiger Global Management and Criterion Capital Management, at least 5% of the outstanding shares, each Selling Shareholder agreed that:

if at any time Great Hill notifies a Selling Shareholder of its desire and intention to designate a single director ( Great Hill Director ) in advance of any meeting of the shareholders for the election of directors or when any other approval is sought with respect to the election of directors, such Selling Shareholder agreed to vote all of its voting shares that are owned or held of record by such Selling Shareholder 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 Shareholder 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 Shareholder agreed to cooperate in causing the requested removal and/or replacement by voting in the appropriate manner.

Each Selling Shareholder also irrevocably granted, and appointed Michael A. Kumin, and any other person who shall be designated by Great Hill, as such Selling Shareholder s proxy and attorney (with full power of substitution), to vote all of such Selling Shareholder 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 Shareholder 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 our articles and memorandum of association, as in effect on December 1, 2005.

As a result of its voting arrangement with the Selling Shareholders, 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.

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**We have entered into a standstill agreement pursuant to which Great Hill and its affiliates are 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 shareholders.**

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 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 shareholders 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 (i) prior to giving effect thereto, the Great Hill Group beneficially owns less than 60% of Total Voting Power and (ii) 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 shareholders.

**We have never paid any dividend and we do not intend 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 shares if you require dividend income. Capital appreciation, if any, of our shares may be your sole source of gain for the foreseeable future.

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

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

Our certificate of incorporation 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. Plus, 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;

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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 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 (or any surviving corporation) are offered to all of the stockholders other than the Acquiring Person at a steep discount to their market value.

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

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not Applicable

**ITEM 2. PROPERTIES**

We do not own any real property. Our headquarters is located in Beverly Hills, California, where we occupy approximately 25,000 square feet of office space that houses our technology department, customer service operations, and most of our corporate and administrative personnel. The current lease ends on July 31, 2008 and has a monthly base rent of \$74,865. On November 27, 2007, we reduced our space requirements to 16,000 square feet and signed an amendment to extend the lease another three years to July 31, 2011 with 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 lease office space in Utah, New York, and Israel. 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**

*Jason Adelman, etc., et al., v. Matchnet plc, etc., et al*

On November 14, 2003, Jason Adelman filed a nationwide class action complaint against us in the Los Angeles County Superior Court based on an alleged violation of California Civil Code section 1694 et seq., which regulates businesses that provide dating services. The complaint included allegations that we are a dating service as defined by the applicable statutes and, as an alleged dating service, we are required to provide language in our contracts that allows (i) members to rescind their contracts within three days, (ii) reimbursement of a portion of the contract price if the member dies during the term of the contract and/or (iii) members to cancel their contracts in the event of disability or relocation. Causes of action include breach of applicable state law, fraudulent and deceptive business practices, breach of contract and unjust enrichment.

On August 8, 2006, the Court granted the Company's application to bifurcate the *Adelman* trial of the issue of actual injury or damages and set the trial for August 17, 2006 (the Bifurcated Damages Trial ). The Court

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determined at the Bifurcated Damages Trial that Adelman did not suffer any actual injury or damages, Adelman's claims were dismissed, and a judgment was entered to award attorneys' fees and costs to the Company. On January 31, 2007, the Court awarded the Company \$50,000 in legal fees. Adelman has filed an appeal seeking to vacate the judgment. In addition, the Company has filed an appeal of the attorneys' fees award in order to seek an award of all of the attorneys' fees incurred in this matter. Although we agree that the Court properly granted our Attorneys' Fees Motion, we believe that the Court should have awarded us attorneys' fees in the full amount we requested, approximately \$390,000, and not the amount actually awarded, \$50,000. Adelman has cross-appealed in attempt to vacate the attorneys' fees award entirely. The Appellate Court heard oral argument on February 19, 2008. On March 20, 2008, the Appellate Court issued an Order Vacating Submission in response to a letter dated March 17, 2008 from the Court of Appeals in which the Court has asked to be briefed on certain additional issues.

*Dinolfo v. Spark Networks plc*

On February 27, 2007, Kenneth J. Dinolfo initiated an action, *Dinolfo v. Spark Networks plc*, in New Jersey Superior Court in Essex County. Mr. Dinolfo alleged claims for violations of his privacy and misappropriation of his likeness under common law and California and New Jersey statutes and sought compensatory and statutory damages and attorneys' fees. The action was removed to the U.S. District Court for the District of New Jersey on April 18, 2007. On May 9, 2007, the Company filed a motion to dismiss or transfer the action for improper venue. On June 28, 2007, the U.S. District Court entered an order granting the motion and transferred the matter to the United States District Court for the Central District of California. On October 25, 2007, the Company filed a Motion to Dismiss the Complaint which was heard on November 19, 2007 and converted to a Motion for Summary Judgment. The Court requested further briefing from Mr. Dinolfo on issues pertinent to the Motion and set a submission deadline of January 2, 2008. On December 12, 2007, the Company and Mr. Dinolfo entered into a confidential settlement agreement. On December 28, 2007, the Court formally entered a dismissal of the entire action with prejudice pursuant to a stipulation by the parties.

*Ami Shafir v. Spark Networks, plc.*

On April 30, 2007, Ami Shafir initiated an action, *Ami Shafir v. Spark Networks, plc.*, in the Superior Court in the State of California alleging claims for breach of written agreement, breach of oral agreement, wages and quantum meruit. The Company filed a demurrer and motion to strike with regard to the claims for breach of oral agreement, wages and quantum meruit. The demurrer and motion to strike were set to be heard on July 12, 2007. Prior to the hearing, Shafir filed a first amended complaint which did not include the cause of action for breach of oral agreement. The Company re-filed its motion to strike which was granted on August 24, 2007. On September 7, Shafir filed his Second Amended Complaint. The Company answered that Complaint on September 14, 2007. A Case Management Conference was held on September 17, 2007, at which time the Court ordered the parties to mediation. On February 29, 2008, the Company and Mr. Shafir entered into a confidential settlement agreement, and on March 3, 2008, the Court formally entered a dismissal of the entire action with prejudice pursuant to a stipulation by the parties.

*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.*

In the above-identified litigation, plaintiff Spark Network Services, Inc. has asserted in an Amended Complaint that Spark Networks, Inc. has 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. has 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.

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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. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On October 8, 2007, we held our 2007 annual meeting of stockholders. At the annual meeting, our stockholders voted to:

- (i) elect two board nominees to serve as directors of Spark Networks, Inc.;
- (ii) approve the reappointment of Ernst & Young LLP as independent registered public accounting firm auditors; and
- (iii) approve the Spark Networks, Inc. 2007 Omnibus Incentive Plan.

The foregoing resolutions were approved by the following numbers of votes for, against and withheld/abstained (or broker non-votes) as identified below:

<b>RESOLUTION</b>	<b>FOR</b>	<b>AGAINST</b>	<b>ABSTAIN</b>	<b>TOTAL</b>
(i) Election of Benjamin A. Derhy	18,647,175	4,100	0	18,651,275
(i) Election of Thomas G. Stockham	18,647,175	4,100	0	18,651,275
(ii) Reappointment of Ernst & Young LLP	18,318,174	333,001	100	18,651,275
(iii) Approval of 2007 Omnibus Incentive Plan	10,111,623	4,624,280	2,446,319	17,182,222

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Spark Networks, Inc.'s common stock is traded on the American Stock Exchange under the trading symbol LOV. At March 28, 2008, there were 66 holders of record of our common stock. Prior to the completion of the Scheme of Arrangement in July 2007, Spark Networks plc's ordinary shares were traded in the form of ADSs on the American Stock Exchange (AMEX) under the trading symbol LOV and in the form of GDSs on the Frankfurt Stock Exchange (the FSE) under the symbol MHJG. Following the completion of our Scheme of Arrangement, our common stock has been traded solely on the American Stock Exchange. The following table summarizes the high and low sales prices of Spark Networks plc's GDSs in euros as reported by the Frankfurt Stock Exchange for the periods prior to the completion of the Scheme of Arrangement and summarizes the high and low sales prices of our common stock as reported by the American Stock Exchange for the periods following completion of the Scheme of Arrangement. The Euro amounts for prices prior to July 9, 2007, are translated into U.S. dollars at the currency exchange rate in effect on the date the price was reported on the FSE. The currency exchange rate is based on the average bid and ask exchange price as reported by OANDA for such dates.

	High		Low	
<b>Year ended December 31, 2006</b>				
First Quarter	6.48	\$ 7.83	5.03	\$ 6.05
Second Quarter	5.35	\$ 6.60	3.78	\$ 4.75
Third Quarter	4.75	\$ 6.08	4.01	\$ 5.13
Fourth Quarter	4.80	\$ 6.17	4.00	\$ 5.23
<b>Year ended December 31, 2007</b>				
First Quarter	4.75	\$ 6.28	3.72	\$ 4.82
Second Quarter	4.70	\$ 6.39	3.95	\$ 5.29
Third Quarter(1)	N/A	\$ 5.60	N/A	\$ 3.90
Fourth Quarter	N/A	\$ 4.98	N/A	\$ 3.60

(1) On July 9, 2007, the Company's common stock started trading solely on the American Stock Exchange. We have not declared or paid any cash dividends on our common shares. 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.

**Performance Graph**

The following information in this Item 5 of this Annual Report on Form 10-K is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing. The performance graph compares the cumulative total stockholder return on Spark Networks plc's ADSs as traded on the American Stock Exchange (for the period commencing on February 14, 2006 and ending on July 9, 2007) or our common stock traded on the American Stock Exchange (for the period commencing on July 9, 2007 and ending on December 31, 2007), the AMEX Market Value (US & Foreign) Index and the RDG Internet Composite Index of comparable companies for the period commencing on January 31, 2006 and ending on December 31, 2007. The graph assumes \$100 invested on December 31, 2006 in our ADSs, the AMEX Market Value (US & Foreign) Index, the RDG Internet Composite Index and reinvestment of dividends. The stock price performance shown on the graph is not necessarily indicative of future price performance.

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\* \$100 invested on 2/14/06 in stock or 1/31/06 in index including reinvestment of dividends.

Fiscal year ending December 31.

**Unregistered Sales of Equity Securities**

During the year ended December 31, 2007, we have issued unregistered securities to the persons described below. None of these transactions involved any underwriters, underwriting discounts or commissions, except as specified below, or any public offering, and we believe that each transaction was exempt from the registration requirements of the Securities Act of 1933 by virtue of Section 4(2) thereof and/or Regulation D promulgated thereunder, except as specified below. All recipients had adequate access, through their relationships with us, to information about us.

In August 2003, we issued warrants to Europlay Capital Advisors, LLC ( ECA ), an accredited investor as defined in Rule 501(a) under Regulation D, for the purchase of up to 1,000,000 ordinary shares at an exercise price of \$2.44 per share in exchange for financial consulting services provided to us by ECA. Of these warrants, 500,000 vested immediately and were exercisable and non-forfeitable; however, a warrant certificate was never issued yet the warrants were treated as issued and outstanding in our financial statements. In December 2004, ECA and our company agreed to accelerate vesting of 250,000 of the remaining 500,000 unvested warrants, and cancel the remaining 250,000 unvested warrants. Accordingly, we issued a warrant certificate for 750,000 shares. From January 1, 2007 to December 31, 2007, pursuant to the terms of the warrant agreement, ECA effected cashless exercises of warrants accounting for a total of 220,000 ordinary shares at a per share exercise price of \$2.76 and we, after accounting for ECA's cashless exercises, issued a total of 124,073 ordinary shares pursuant to such exercises. As of December 31, 2007, all warrants were exercised.



**Table of Contents****Purchases of Equity Securities**

On March 10, 2008, we announced the approval of a share repurchase program whereby the Company was authorized to repurchase up to one million shares of the Company's outstanding common stock. On March 14, 2008, we announced an increase in the size of the current share repurchase program from one million to 1.5 million shares of our outstanding common stock.

The table below sets forth information regarding our purchase of our common stock during the three months ended December 31, 2007, all of which occurred in one privately negotiated transaction on November 29, 2007:

		<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program</b>
October 1	October 31		n/a	
November 1	November 30	695,000	\$ 4.00	
December 1	December 31		n/a	
Total		695,000		

**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth our selected consolidated financial data. The data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements, related notes, and other financial information included herein. The following selected consolidated statement of operations data for each of the three years ended in the period December 31, 2007, and the selected consolidated balance sheet data as of December 31, 2007 and 2006, are derived from the audited consolidated financial statements of our company included elsewhere in this report. The consolidated statement of operations data for the years ended December 31, 2004 and 2003 and the selected consolidated balance sheet data as of December 31, 2005, 2004 and 2003 are derived from the audited consolidated financial statements of our company not included in this report. Our common stock currently trades on the American Stock Exchange. The historical results are not necessarily indicative of results to be expected in any future period.

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(in thousands, except per share amounts)	Years ended December 31, (1)				
	2007	2006	2005	2004	2003
<b>Consolidated Statements of Operations Data:</b>					
Net revenues	\$ 65,218	\$ 68,853	\$ 65,511	\$ 65,052	\$ 36,941
Direct marketing expenses	21,095	24,574	24,411	31,240	18,395
Contribution	44,123	44,279	41,100	33,812	18,546
Operating expenses:(6)					
Sales and marketing	3,626	2,890	2,661	2,607	986
Customer service	3,103	3,560	2,827	3,379	2,536
Technical operations	4,416	6,239	6,156	7,184	4,481
Development	4,249	4,766	5,194	2,013	959
General and administrative	21,848	18,923	23,935	29,253 <sup>(2)</sup>	18,537
Amortization of intangible assets other than goodwill	1,356	1,184	1,085	860	555
Impairment of long-lived assets	1,894	114	105	208	1,532
Total operating expenses	40,492	37,676	41,963	45,504	29,586
Operating income (loss)	3,631	6,603	(863)	(11,692)	(11,040)
Interest (income) and other expenses, net	(913)	(696)	711	(66)	(188)
Income (loss) before income taxes	4,544	7,299	(1,574)	(11,626)	(10,852)
Provision benefit for income taxes	(4,434)	736	(136)	1	
Net income (loss)	\$ 8,978	\$ 6,563	\$ (1,438)	\$ (11,627)	\$ (10,852)
Net income (loss) per share basic <sup>(3)</sup>	\$ 0.31	\$ 0.21	\$ (0.06)	\$ (0.51)	\$ (0.57)
Net income (loss) per share diluted <sup>(3)</sup>	\$ 0.31	\$ 0.21	\$ (0.06)	\$ (0.51)	\$ (0.57)
Weighted average shares outstanding-basic <sup>(3)</sup>	29,218	30,580	26,105	22,667	18,970
Weighted average shares outstanding-diluted <sup>(3)</sup>	29,250	31,248	26,105	22,667	18,970
<b>Other Financial Data:</b>					
Depreciation	1,684	2,968	3,624	3,065	1,441
<b>Additional Information:</b>					
Average paying subscribers <sup>(4)</sup>	215,323	236,868	214,793	226,093	125,843

Operating expenses include share-based compensation as follows <sup>(6)</sup> :	Years Ended December 31,				
	2007	2006	2005	2004	2003
Sales and marketing	\$ 884	\$ 620	\$ 329	\$ 156	\$ 79
Customer service	117	77	43		
Technical operations	633	434	241	22	140
Development	534	437	239		
General and administrative	\$ 3,153	\$ 2,299	\$ 1,865	\$ 1,526	\$ 1,652

Consolidated Balance Sheet Data:	Years Ended December 31,				
	2007	2006	2005	2004	2003
Cash, cash equivalents and marketable securities	\$ 8,996	\$ 20,608	\$ 17,292	\$ 7,423	\$ 5,815
Total assets	43,608	51,626	48,620	27,359	16,969
Deferred revenue	4,140	4,051	4,991	3,933	3,232
Capital lease obligations and notes payable	21	1,416	10,830	1,873	487
Total liabilities	12,700	13,721	23,437	16,872	11,659
Shares subject to rescission <sup>(5)</sup>	7,480	8,079	6,089	3,819	
Accumulated deficit	(29,532)	(38,510)	(45,073)	(43,635)	(32,008)
Total shareholders' equity	\$ 23,428	\$ 29,826	\$ 19,094	\$ 6,668	\$ 5,310



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- (1) Refer to Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of certain asset and business acquisitions.
- (2) In 2004, general and administrative expenses included an expense of approximately \$2.4 million related to an employee severance, \$2.1 million related to the United States initial public offering of MatchNet, Inc. that was planned for mid-2004, but which was withdrawn shortly after the related registration statement was filed in the third quarter of 2004, as well as one legal settlement resulting in the recognition of \$900,000 in expenses in the third quarter and two legal settlements resulting in the recognition of \$2.1 million in expenses in the fourth quarter of 2004. In 2003, general and administrative expenses included a charge of \$1.7 million primarily related to a settlement with Comdisco.
- (3) For information regarding the computation of per share amounts, refer to note 1 of our consolidated financial statements.
- (4) Average Paying Subscribers: 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.
- (5) Under our 2000 Executive Share Option Scheme ( 2000 Option Scheme ), we granted options to purchase ordinary shares to certain of our employees, directors and consultants. The issuances of securities upon exercise of options granted under our 2000 Option Scheme may not have been exempt from registration and qualification under federal and California state securities laws, and as a result, we may have potential liability to those employees, directors and consultants to whom we issued securities upon the exercise of these options. In order to address that issue, we may elect to make a rescission offer to those persons who exercised all, or a portion, of those options and continue to hold the shares issued upon exercise, to give them the opportunity to rescind the issuance of those shares. However, it is the Securities and Exchange Commission's position that a rescission offer will not bar or extinguish any liability under the Securities Act of 1933 with respect to these options and shares, nor will a rescission offer extinguish a holder's right to rescind the issuance of securities that were not registered or exempt from the registration requirements under the Securities Act of 1933. As of December 31, 2007, assuming every eligible person that continues to hold the securities issued upon exercise of options granted under the 2000 Option Scheme were to accept a rescission offer, we estimate the total cost to us to complete the rescission would be approximately \$7.5 million including statutory interest at 7% per annum, accrued since the date of exercise of the options. The rescission acquisition price is calculated as equal to the original exercise price paid by the option recipient to our Company upon exercise of their option.
- (6) For the purposes of this and all future filings, prior period share-based compensation was reclassified to conform to current period classification.

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**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 words. These forward-looking statements are based 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 ( Spark Networks Limited ). As of the completion of our reorganization on July 9, 2007, through the Scheme of Arrangement, the shares of Spark Networks, Inc., a Delaware corporation and Spark Networks Limited's parent entity, have been traded on the American Stock Exchange and the Company has become Spark Networks 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.

Our revenues have grown from \$659,000 in 1999 to \$65.2 million in 2007. For the year ended December 31, 2007, we had 215,323 average paying subscribers, representing a decrease of 9% from the year ended December 31, 2006. 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.com, which targets the singles in the United States, BlackSingles.com, which primarily targets the 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

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markets, leveraged and enhanced our existing brands to improve our position within new markets, and gained valuable intellectual property. During the last three years, we made the following acquisitions:

On October 22, 2007, we entered into an agreement to purchase the stock of Kizmeet.com, a free, ad-supported, missed connections web site. Since the majority of the purchase was related to the domain name, we recorded the entire purchase price of \$360,000 as a domain name subject to annual impairment testing under SFAS 142. Kizmeet is a complement to our current advertising offering and extends our reach with a service that caters to a different audience than our traditional online personals communities.

On February 1, 2007, we purchased the assets of HurryDate, a leading online personals and singles events company, for total consideration of \$2.3 million (\$2.0 million of which was paid in cash at the time of closing) and, subject to certain conditions in the purchase agreement, payment of an earn-out based upon the operating income of the HurryDate business for the period from April 1, 2007 to March 31, 2008. In the second quarter of 2007, we paid the remaining \$250,000 of the initial cash consideration. On October 17, 2007, we entered into a letter agreement with the sellers and agreed that the first and second earn-out payments would each be \$770,000 and the third earn-out payment would be \$660,000. These amounts assume that the sellers are entitled to a full earn-out payment pursuant to the purchase agreement. The purchase of HurryDate expands our offline presence and solidifies our position as the only leading online personals provider to effectively marry the online and offline dating worlds. Of the \$2.2 million of acquired intangible assets, \$490,000 was assigned to member databases and will be amortized over three years, \$50,000 was assigned to subscriber databases which was amortized over five months, \$800,000 was assigned to developed software which will be amortized over five years, \$360,000 was assigned to domain names which are not subject to amortization, and \$480,000 was assigned to goodwill.

On December 7, 2006, we acquired the assets of Stu and Lew Productions, creator of Schmooz-A-Palooza, an annual event held in December, for \$50,000. We believe this acquisition further strengthens JDate's offline presence and solidifies its connection to Jewish singles, most notably in the Los Angeles market.

On May 5, 2006, we completed the purchase of certain assets of LDSSingles Inc., a company that operates a religious online singles community, for \$2.3 million, of which \$2.0 million was paid up front in cash and \$300,000 was settled in cash, net of liabilities, on the one year anniversary of the acquisition. We believe that the acquisition of LDSSingles strengthened our market share in the LDS online singles niche, particularly in the LDS market.

On May 19, 2005, we acquired MingleMatch, Inc., a company that operates religious, ethnic, special interest and geographically targeted online singles communities for \$12 million in cash, 150,000 shares of the Company valued at approximately \$1.1 million and capitalized acquisition costs of \$100,000. The acquisition of MingleMatch fits with our strategy of creating affinity-focused online personals communities that provide quality experiences for our members.

Our future performance will depend on many factors, including:

continued acceptance of online personals services;

our ability to attract a large number of new members and paying subscribers, and retain those members and paying subscribers;

our ability to increase brand awareness, both domestically and internationally;

our ability to sustain and, when possible, increase subscription fees for our services; and

our ability to introduce new targeted Web sites, fee-based services and advertising as additional sources of revenues. 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

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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 personal experiences. We believe that we have sufficient cash resources on hand to accomplish the enhancements that are 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, revenues 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, prepaid advertising, Web site and software development costs, goodwill, intangible and other long-lived assets, accounting for business combinations, contingencies and income taxes. 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 revenues are derived from subscription fees. Revenues are presented net of credits and credit card chargebacks. We recognize revenue in accordance with accounting principles generally accepted in the United States and with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition.

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 and determinable, and collection is reasonably assured. Paying subscribers primarily pay in advance using a credit card and, subject to certain conditions identified in our terms and conditions, all purchases are final and nonrefundable. Subscription fees collected in advance are deferred and recognized as revenue, using the straight-line method, over the term of the subscription. We reserve for potential credit card chargebacks based on our historical chargeback experience.

### **Direct Marketing Expenses**

We incur substantial expenses related to our advertising in order to generate traffic to our Web sites. These advertising costs primarily consist of online advertising. We have entered into numerous affiliate arrangements, under which an affiliate advertises or promotes our Web site, and typically earns a fee whenever one of its users clicks through an advertisement to one of our Web sites and registers or subscribes on such Web site. Affiliate deals may fall in to one of many categories, including the CPS, CPA, CPC, and CPM categories discussed below. We do not typically have any exclusivity arrangements with our affiliates and some of our affiliates are also affiliates of our competitors.



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

Cost per subscription (CPS), where we pay an online advertising provider a fee based upon the number of new paying subscribers that 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 direct marketing expenses 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.

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

We capitalize costs related to developing or obtaining internal-use software. Capitalization of costs begins after the conceptual formulation stage has been completed. Product development costs are expensed as incurred or capitalized into property and equipment in accordance with Statement of Position ( SOP ) 98-1 Accounting for the Costs of Computer Software Developed or Obtained for Internal Use . SOP 98-1 requires that 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 be capitalized. We exercise judgment in determining which stage of development a software project is in at any point in time.

In accordance with Emerging Issues Task Force ( EITF ) 00-2 Accounting for Web Site Development Costs, we expense costs related to the planning and post-implementation phases of our 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. In accordance with the above accounting literature, we estimate the amount of time spent by our engineers in developing our software and enhancements to our Web sites.

On a regular basis, management reviews the capitalized costs of Web sites and software developed to ensure that these costs relate to projects that will be completed and placed in service. Any projects determined not to be viable will be reviewed for impairment in accordance with SFAS No. 144.

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

We test goodwill and indefinite-lived intangible assets for impairment in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets and test property, plant and equipment, and other intangible assets for impairment in accordance

with SFAS No. 144, Accounting for the

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Impairment or Disposal of Long-Lived Assets. We assess goodwill and other indefinite-lived intangible assets at least annually, or more frequently when circumstances indicate that the carrying value may not be recoverable. Factors we consider important and which could trigger an impairment review include the following:

a significant decline in actual 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 market value of an asset;

a shift in technology demands and development; and

a significant turnover in key management or other personnel.

When we determine that the carrying value of goodwill, 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 the first quarter of 2007, we undertook certain marketing initiatives designed to reverse the decline in revenues for our AmericanSingles web site. While partially successful, the initiatives at that time did not increase new subscriber additions to the point that subscriber levels stabilized, and management determined that spending required for the marketing initiatives was not sustainable and thus they were terminated. An analysis of the expected cash flows from the web site after the first quarter initiatives were terminated resulted in expectations of future profitability for the site that were insufficient to sustain the carrying value of goodwill on the Company's balance sheet. Accordingly, the Company recorded a \$1.9 million impairment expense related to the removal of the book carrying value of goodwill under SFAS 142 related to AmericanSingles in the first quarter of 2007. In 2006, after conducting our annual analysis of intangible assets and other long-lived assets, we determined that some of the domain names with indeterminate lives were deemed to have lost their value and as a result we recognized impairment expense of \$114,000. No indicators of impairment in goodwill were present in 2006 and no indicators of impairment of goodwill or other intangible assets were present in 2005.

## **Accounting for Business Combinations**

We have acquired the stock or specific assets of a number of companies from 1999 through 2007 some of which were considered to be business acquisitions. Under the purchase method of accounting, the cost, including transaction costs, are allocated to the underlying net assets, based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill.

## Edgar Filing: SPARK NETWORKS INC - Form 10-K

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 useful lives that differ. 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.

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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.

We used the equity method of accounting for our investment in affiliates over which we exert significant influence. Significant influence is generally having between a 20% to 50% ownership interest. At December 31, 2005, we owned a 20% interest in Playahead (Duplo) AB which we accounted for using the equity method. On October 19, 2006, the Company sold all its shares in Playahead AB for \$1.4 million in cash and recognized a gain of approximately \$300,000.

### **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 accordance with the provisions of SFAS No. 109, Accounting for Income Taxes, 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. In 2006, we recorded a valuation allowance to reduce deferred tax assets to the amount expected to more likely than not be realized in our future tax returns.

At December 31, 2007, we had gross net operating loss carry-forwards for income tax purposes of approximately \$41.0 million and \$34.2 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2018 through 2024 for federal purposes and in 2012 through 2014 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 \$1.5 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.

As a result of the adoption of SFAS No. 123(R) 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 net operating loss carry forwards (NOL) resulting from excess tax benefits. As of December 31, 2007, deferred tax assets do not include approximately \$13.4 million of these excess tax benefits

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from employee stock option exercises that are a component of the Company's net operating loss carry forwards. Additional paid in capital will be increased up to an additional \$13.4 million if and when such excess tax benefits are realized.

### **Stock Based Compensation**

Prior to July 1, 2005, we accounted for employee stock-based compensation using the intrinsic value method supplemented by pro forma disclosures in accordance with Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ) and Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* ( SFAS 148 ). Effective July 1, 2005, we adopted SFAS No. 123R, *Share-Based Payment* ( SFAS 123R ) using the modified prospective approach and accordingly prior periods have not been restated to reflect the impact of SFAS 123R. Under that transition method, compensation cost recognized in the second half of 2005 includes:

(i) compensation cost for all share-based payments granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (ii) compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R).

We calculate the fair value of stock options by using the Black-Scholes option-pricing model. The determination of the fair value of share-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 share-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 share price behavior and assessing management's expectations of share price behavior during the term of the option. The expected term of options granted was derived by averaging the vesting term with the contractual term.

Prior to our adoption of Statement 123(R), we 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. Statement 123(R) 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.

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.

In connection with the application of SFAS 123R in the fourth quarter of 2007, we noted errors in the adoption of SFAS 123R which created errors that were in the aggregate immaterial to our consolidated financial statements taken as a whole. Refer to Note 14 of the notes to the consolidated financial statements included in this annual report.

### **Segment Reporting**

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

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co-branded and private label Web sites; General Market Networks, which consists of AmericanSingles.com, Date.co.uk, Date.ca 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 change, in compliance with Financial Accounting Standard No. 131, Disclosures about Segments of an Enterprise and Related Information, is a result of the change to the Company's overall revenue mix. The Company believes the new segments will provide investors with a more accurate picture of the performance of the business.

	(in thousands)	Year Ended December 31,		
		2007	2006	2005
<b>Net Revenues</b>				
Jewish Networks		\$ 33,624	\$ 32,213	\$ 29,500
General Market Networks		15,707	25,446	31,710
Other Affinity Networks		13,314	9,724	2,766
Offline and Other Businesses		2,573	1,470	1,535
<b>Total Net Revenues</b>		<b>\$ 65,218</b>	<b>\$ 68,853</b>	<b>\$ 65,511</b>
<b>Direct Marketing Expenses</b>				
Jewish Networks		\$ 3,281	\$ 4,544	\$ 3,929
General Market Networks		8,462	13,711	17,759
Other Affinity Networks		&nbs		