

SPARK NETWORKS INC
Form 10-Q
May 13, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2010

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission file number: 001-32750

SPARK NETWORKS, INC.

(Exact name of registrant as specified in its charter)

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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)

(323) 658-3000

(Registrant's telephone number, including area code)

Not Applicable.

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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 Exchange Act). Yes No

The registrant had 20,586,544 shares of common stock, par value \$0.001 per share, outstanding as of May 13, 2010.

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SPARK NETWORKS, INC.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****SPARK NETWORKS, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

| | March 31, 2010 (unaudited) | December 31, 2009 |
|---|----------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 6,099 | \$ 6,223 |
| Restricted cash | 670 | 681 |
| Accounts receivable | 866 | 684 |
| Deferred tax asset - current | 221 | 221 |
| Prepaid expenses and other | 940 | 853 |
| Total current assets | 8,796 | 8,662 |
| Property and equipment, net | 2,217 | 2,277 |
| Goodwill | 8,862 | 8,758 |
| Intangible assets, net | 3,466 | 3,586 |
| Deferred tax asset - non-current | 4,707 | 4,707 |
| Deposits and other assets | 1,870 | 1,866 |
| Total assets | \$ 29,918 | \$ 29,856 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 377 | \$ 1,415 |
| Accrued liabilities | 3,519 | 4,232 |
| Deferred revenue | 4,304 | 4,244 |
| Total current liabilities | 8,200 | 9,891 |
| Deferred tax liability | 703 | 663 |
| Other liabilities - non-current | 997 | 978 |
| Total liabilities | 9,900 | 11,532 |
| Commitments and contingencies (Note 7) | | |
| Stockholders' equity: | | |
| Authorized capital stock consists of 100,000,000 shares of common stock, \$0.001 par value; issued and outstanding 20,586,544 and 20,581,544 at March 31, 2010 and December 31, 2009, respectively: | 21 | 21 |
| Additional paid-in-capital | 49,540 | 48,813 |
| Accumulated other comprehensive income | 676 | 638 |
| Accumulated deficit | (30,219) | (31,148) |
| Total stockholders' equity | 20,018 | 18,324 |
| Total liabilities and stockholders' equity | \$ 29,918 | \$ 29,856 |

See accompanying notes.

Table of Contents**SPARK NETWORKS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(unaudited, in thousands, except per share data)

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2010 | 2009 |
| Revenue | \$ 10,537 | \$ 12,032 |
| Cost and expenses: | | |
| Cost of revenue (exclusive of depreciation shown separately below) | 3,157 | 3,655 |
| Sales and marketing | 1,083 | 921 |
| Customer service | 396 | 545 |
| Technical operations | 363 | 393 |
| Development | 781 | 1,267 |
| General and administrative | 2,787 | 2,773 |
| Depreciation | 235 | 206 |
| Amortization of intangible assets other than goodwill | 122 | 184 |
| Impairment of goodwill, long-lived assets and other assets | 121 | 880 |
| Total cost and expenses | 9,045 | 10,824 |
| Operating income | 1,492 | 1,208 |
| Interest (income) and other expenses, net | (41) | 492 |
| Income before income taxes | 1,533 | 716 |
| Provision for income taxes | 604 | 405 |
| Net income | \$ 929 | \$ 311 |
| Net income per share basic and diluted | \$ 0.05 | \$ 0.02 |
| Weighted average shares outstanding basic | 20,582 | 20,548 |
| Weighted average shares outstanding diluted | 20,582 | 20,563 |
| Prior period amounts have been reclassified to conform to current period presentation and include stock-based compensation as follows: | | |

| | Three Months Ended March 31, | |
|----------------------------|---|-------------|
| | 2010 | 2009 |
| Cost of revenue | \$ 2 | \$ 10 |
| Sales and marketing | 117 | 48 |
| Customer service | 1 | 5 |
| Technical operations | 73 | 40 |
| Development | 13 | 41 |
| General and administrative | 504 | 181 |

See accompanying notes.

Table of Contents**SPARK NETWORKS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited, in thousands)**

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net income | \$ 929 | \$ 311 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 357 | 390 |
| Foreign exchange (gain) loss on intercompany loan | (74) | 422 |
| Impairment of goodwill and long-lived assets | 121 | 880 |
| Stock-based compensation | 710 | 325 |
| Deferred taxes | 40 | (27) |
| Non-current taxes payable and other | (20) | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (182) | 252 |
| Restricted cash | 11 | 63 |
| Prepaid expenses and other assets | (66) | 364 |
| Accounts payable and accrued liabilities | (1,751) | (1,843) |
| Deferred revenue | 60 | 38 |
| Net cash provided by operating activities | 135 | 1,175 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (274) | (427) |
| Earn-out payment for acquisition of business | | (770) |
| Net cash used in investing activities | (274) | (1,197) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock | 15 | 7 |
| Net cash provided by financing activities | 15 | 7 |
| Net decrease in cash | (124) | (15) |
| Cash and cash equivalents at beginning of period | 6,223 | 7,417 |
| Cash and cash equivalents at end of period | \$ 6,099 | \$ 7,402 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ | \$ 57 |
| Cash paid for income taxes | \$ 85 | \$ 181 |

See accompanying notes.

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. The Company and Summary of Significant Accounting Policies

The Company

The common stock of Spark Networks, Inc., a Delaware corporation (the "Company"), is traded on the NYSE Amex. 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.

The Company has evaluated all subsequent events through the date the financial statements were issued.

Basis of Presentation

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

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

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States ("GAAP") requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to uncollectible receivables, the useful lives of long-lived assets including property and equipment, goodwill and other intangible assets, income taxes, and contingencies. In addition, the Company uses assumptions when employing the Black-Scholes option valuation model to calculate the fair value of granted stock-based awards. The Company bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results may differ from these estimates.

The consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2009 was derived from the Company's audited financial statements for the year ended December 31, 2009.

Fair Value Measurement

Effective January 1, 2008, the Company adopted the methods of fair value as described in the Fair Value Measurements and disclosures guidance. It clarifies that fair value is an exit price, representing the amount that would be received in a sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement

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that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

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

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

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

As of March 31, 2010, the Company has financial assets that consist of cash and cash equivalents, which are measured at fair value using quoted prices for identical assets in an active market (Level 1 fair value hierarchy).

Comprehensive Income

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

| | Three Months Ended March 31, | |
|---|---|---------------|
| | 2010 | 2009 |
| Net income | \$ 929 | \$ 311 |
| Foreign currency translation adjustment, net of taxes | 38 | 146 |
| Total comprehensive income | \$ 967 | \$ 457 |

2. Net Income per Share

The Company calculates and presents the net income per share of both basic and diluted net income per share. Basic net income per share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding. Diluted net income per share includes the effect of potential shares of stock outstanding, including dilutive stock options and warrants, using the treasury stock method.

| | For the Three Months Ended March 31, | |
|---|---|----------------|
| | 2010 | 2009 |
| | <i>(in thousands except per share data)</i> | |
| Net Income Per Share of Common Stock Basic | | |
| Net income applicable to common stock | \$ 929 | \$ 311 |
| Weighted average shares outstanding basic | 20,582 | 20,548 |
| Basic Net Income Per Share | \$ 0.05 | \$ 0.02 |
| Net Income Per Share of Common Stock Diluted | | |

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| | | | | |
|--|-----------|-------------|-----------|-------------|
| Net income applicable to common stock | \$ | 929 | \$ | 311 |
| Weighted average shares outstanding basic | | 20,582 | | 20,548 |
| Dilutive options using the treasury stock method | | | | 15 |
| Weighted average shares outstanding diluted | | 20,582 | | 20,563 |
| Diluted Net Income Per Share | \$ | 0.05 | \$ | 0.02 |

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Options to purchase 3.2 million shares and 3.6 million shares for the three months ending March 31, 2010 and 2009, respectively, were not included in the computation of diluted net income per share because the exercise price of such options was above the average stock price for the period and, therefore, the options were considered anti-dilutive.

3. Acquisitions of Businesses and Intangibles

In February 2007, the Company purchased the assets of HurryDate, a leading online personals and singles events company. Of the \$4.3 million cash consideration paid, \$490,000 was assigned to member databases and is being amortized over three years, \$50,000 was assigned to subscriber databases and was amortized over five months, \$800,000 was assigned to developed software which is being amortized over five years, \$360,000 was assigned to domain names which are not subject to amortization and the remainder was assigned to goodwill. In 2008 the Company impaired the goodwill balance associated with HurryDate. The Company paid \$770,000 and \$585,000 towards the final HurryDate earn-out payments in the first and fourth quarters of 2009, respectively, and expensed each payment as impairment expense.

4. Revolving Credit Facility

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

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

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

The Company was compliant with the Amended Agreement's customary affirmative and negative covenants, as of March 31, 2010.

At March 31, 2010, there was no outstanding amount under the Amended Agreement. In connection with the amendment in September 2009, the Company paid deferred financing costs of approximately \$21,000. In connection with the Initial Agreement, the Company paid deferred financing costs of approximately \$446,000. Costs associated with both the Initial and the Amended Agreements were included in prepaid expenses and other, and deposits and other assets. In the third quarter of 2009, the Company wrote off \$36,000 of the remaining deferred financing costs associated with the Initial Agreement, reflecting a \$5.0 million reduction in the revolving credit facility. The remaining deferred financing costs are amortized to interest expense in the Consolidated Statements of Operations over the full term of the Amended Agreement. Amortization expense for the deferred financing costs for the three months ended March 31, 2010 and March 31, 2009 were \$35,000 and \$37,000, respectively.

Table of Contents**5. Stockholders Equity*****Re-Pricing of Employees Options***

On January 5, 2009, the Company re-priced options for certain key employees. The exchange of options was treated as a synthetic re-pricing, which includes a cancellation and replacement of equity instruments. The estimated incremental expense was approximately \$1 million and will be recognized over the four year vesting term of the newly issued options. The incremental expense recognized for the three months ended March 31, 2010 and 2009 were \$210,000 and \$115,000, respectively.

Employee Stock Option Plans

As of July 9, 2007, pursuant to the completion of the Scheme of Arrangement, the Company adopted the Spark Networks, Inc. 2007 Omnibus Incentive Plan (the 2007 Plan) initially authorizing and reserving 2.5 million shares, which may increase on January 1 of each year. Prior to the Company's incorporation and Scheme of Arrangement, Spark Networks plc had two Option Plans, the MatchNet plc 2000 Executive Share Option Plan (the 2000 Plan) and Spark Networks plc 2004 Share Option Plan (the 2004 Plan). No further options are granted under the 2000 Plan or the 2004 Plan; however, all outstanding options previously granted under those plans continue in full force and effect.

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

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

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

As of March 31, 2010, total unrecognized compensation cost related to unvested stock options was \$2.4 million. This cost is expected to be recognized over a weighted-average period of three years. The following table describes option activity for the three months ended March 31, 2010:

| | Number of Shares (in thousands) | Weighted Average Price Per Share |
|----------------------------------|---------------------------------------|--|
| Outstanding at December 31, 2009 | 3,387 | \$ 3.28 |
| Granted | | |
| Exercised | (5) | 3.00 |
| Forfeited | (48) | 2.95 |
| Expired | (68) | 5.26 |
| Outstanding at March 31, 2010 | 3,266 | 3.13 |

Table of Contents**Stockholder Rights Plan**

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

6. Segment Information

The Company has four operating segments: Jewish Networks, which consists of JDate.com, JDate.co.il, JDate.co.uk, JDate.fr, Cupid.co.il 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 including BlackSingles.com and ChristianMingle.com; General Market Networks, which consists of AmericanSingles.com and Date.ca which were both rebranded as Spark.com in December of 2009 and Date.co.uk which was rebranded as Spark.com in February 2010 and their respective co-branded and private label Web sites; and Offline & Other Businesses, which consists of revenue generated from offline activities, HurryDate events and subscriptions to HurryDate.com.

| <i>(in thousands)</i> | Three Months Ended March 31, | |
|--|---|------------------|
| | 2010 | 2009 |
| Revenue | | |
| Jewish Networks | \$ 7,080 | \$ 7,583 |
| Other Affinity Networks | 2,974 | 3,297 |
| General Market Networks | 370 | 940 |
| Offline & Other Businesses | 113 | 212 |
| Total Revenue | \$ 10,537 | \$ 12,032 |
| Direct Marketing Expenses | | |
| Jewish Networks | \$ 507 | \$ 563 |
| Other Affinity Networks | 1,714 | 1,965 |
| General Market Networks | 139 | 273 |
| Offline & Other Businesses | 43 | 49 |
| Total Direct Marketing Expenses | \$ 2,403 | \$ 2,850 |
| Unallocated operating expenses | 6,642 | 7,974 |
| Operating income | \$ 1,492 | \$ 1,208 |

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

7. Commitments and Contingencies**Legal Proceedings**

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Please refer to our Annual Report on Form 10-K for the year ended December 31, 2009 for a description of litigation and claims.

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.

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On January 30, 2007, Spark Network Services, Inc. initiated an action in the United States District Court for the Northern District of Illinois, Eastern Division. On December 4, 2007, Plaintiff, Spark Networks Services, filed an Amended Complaint, adding Spark Networks, Inc. as a defendant. Spark Networks Services asserted in the Amended Complaint that Spark Networks, Inc. infringed certain claims of U.S. Patent No. 6,272,467 by allegedly using the 467 patent's claimed methods for automated two way matching of selected traits and preferences for determining the users' compatibility. Spark Networks, Inc. filed an Answer in which it denied infringing the 467 patent and asserted that the 467 patent is invalid. On January 7, 2008, defendants Match.com and eHarmony.com filed a motion asking the Court to stay the litigation pending the outcome of a reexamination proceeding that had been requested in the U.S. Patent Office with respect to the 467 patent. The reexamination request alleges that the asserted (and other) claims of the 467 patent are invalid based on certain prior art. On January 28, 2008, the reexamination request was granted by the Patent Office. The litigation was then stayed on February 21, 2008. In exchange for a mutual release of claims, the parties settled the case on March 16, 2010 and on March 22, 2010, a stipulated proposed order to dismiss the case was filed with the court. On March 24, 2010, the case was dismissed with prejudice.

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

8. Impairment of Goodwill and Long-lived Assets

In the first quarter of 2009, the Company paid \$770,000 to the former owners of HurryDate pursuant to an earn-out arrangement (see Note 3). The payment was recorded as an increase of goodwill and was impaired in the same quarter due to an analysis which concluded that a sustained decline in HurryDate's speed dating business had reduced projected cash flows below the carrying amount of the reporting unit.

Additionally, in the first quarter of 2010 and 2009, the Company impaired approximately \$121,000 and \$110,000 of capitalized software development costs when it was determined that certain web-based products failed to perform to Company standards.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and the related notes that are included in this Quarterly Report and the audited consolidated financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 Annual Report).

Some of the statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Quarterly Report are forward-looking statements that involve substantial risks and uncertainties. All statements other than historical facts contained in this report, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as believes, expects, anticipates, intends, estimates, may, will, continue, should, plan, predict, potential and other similar expressions. We have based these forward-looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Our actual results could differ materially from those anticipated in these forward-looking statements, which are subject to a number of risks, uncertainties and assumptions including, but not limited to our ability to: attract members; convert members into paying subscribers and retain our paying subscribers; develop or acquire new product offerings and successfully implement and expand those offerings; keep pace with rapid technological changes; maintain the strength of our existing brands and maintain and enhance those brands and our dependence upon the telecommunications infrastructure and our networking hardware and software infrastructure; identify and consummate strategic acquisitions and integrate acquired companies or assets; obtain financing on acceptable terms; and successfully implement both cost cutting initiatives and our current long-term growth strategy, and other factors described in the Risk Factors section of our 2009 Annual Report.

General

The common stock of Spark Networks, Inc. (the Company) is traded on the NYSE Amex. 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.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these unaudited Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, intangible and other long-lived assets, stock-based compensation and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be 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. There were no significant changes to our critical accounting policies during the three months ended March 31, 2010, as compared to those policies disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Segment Reporting

For segment information, please refer to Note 6 of the Notes to the Consolidated Financial Statements the (Notes) elsewhere in this report.

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Key Metric - Average Paying Subscribers

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

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Unaudited selected statistical information regarding average paying subscribers for our operating segments is shown in the table below.

| | Three Months Ended March 31, | |
|-----------------------------------|---|----------------|
| | 2010 | 2009 |
| Average Paying Subscribers | | |
| Jewish Networks | 93,235 | 84,644 |
| Other Affinity Networks | 68,124 | 64,393 |
| General Market Networks | 7,813 | 17,810 |
| Offline & Other Businesses | 661 | 1,157 |
| Total | 169,833 | 168,004 |

Average paying subscribers for the Jewish Networks segment increased 10.1% to 93,235 for the three months ended March 31, 2010 compared to 84,664 in the same period last year. Average paying subscribers for the Other Affinity Networks segment increased 5.8% to 68,124 for the three months ended March 31, 2010 compared to 64,393 in the same period last year. Average paying subscribers for the General Market Networks segment decreased 56.1% to 7,813 for the three months ended March 31, 2010 compared to 17,810 in the same period last year.

Results of Operations

The following table presents our operating results as a percentage of revenue:

| | 2010 | 2009 |
|--|---------------|---------------|
| Revenue | 100.0% | 100.0% |
| Cost and expenses: | | |
| Cost of revenue | 30.0 | 30.4 |
| Sales and marketing | 10.3 | 7.7 |
| Customer service | 3.8 | 4.5 |
| Technical operations | 3.4 | 3.3 |
| Development | 7.4 | 10.5 |
| General and administrative | 26.4 | 23.1 |
| Depreciation | 2.2 | 1.7 |
| Amortization of intangible assets other than goodwill | 1.2 | 1.5 |
| Impairment of goodwill, long-lived assets and other assets | 1.1 | 7.3 |
| Total cost and expenses | 85.8 | 90.0 |
| Operating income | 14.2 | 10.0 |
| Interest (income) and other expenses, net | (0.3) | 4.0 |
| Income before income taxes | 14.5 | 6.0 |
| Provision for income taxes | 5.7 | 3.4 |
| Net income | 8.8% | 2.6% |

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Substantially all of our revenue is derived from subscription fees. Approximately 4% of our revenue for the three months ended March 31, 2010 and 2009, respectively, are generated through offline social and travel events, and advertising revenue. Revenue is presented net of credits and credit card chargebacks. Our subscriptions are offered in durations of varying length (typically, one, three, six and twelve months). Plans with durations longer than one month are available at discounted monthly rates. Following their initial terms, most subscriptions renew automatically for subsequent one-month periods until subscribers terminate them.

Revenue decreased 12.4% to \$10.5 million in the first quarter of 2010 compared to \$12.0 million in the first quarter of 2009. The decrease can be attributed to lower subscription revenue in our Jewish, Other Affinity and General Market Networks segments. Revenue for the Jewish Networks segment decreased 6.6% to \$7.1 million in the first quarter of 2010 compared to \$7.6 million in the first quarter of 2009. The decrease in revenue is primarily driven by lower average revenue per user (ARPU), reflecting a shift in the mix of plans purchased by our subscribers and their related price points, as we focused on growing our network. Revenue for our Other Affinity Networks segment decreased 9.8% to \$3.0 million in the first quarter of 2010 compared to \$3.3 million in the first quarter of 2009. The decrease in revenue results from a 12.8% reduction in direct marketing investment and lower ARPU. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related price points as we shifted our focus to a select group of brands within this segment. Revenue for the General Market Networks segment decreased 60.6% to \$370,000 in the first quarter of 2010, compared to \$940,000 in the first quarter of 2009. The decrease in revenue is due to a decrease in average paying subscribers, reflecting management's decision to eliminate inefficient online marketing investments. Revenue of our Offline & Other Businesses segment decreased 46.7% to \$113,000 in the first quarter of 2010 compared to \$212,000 in the first quarter of 2009. The lower revenue reflects a reduction in events hosted in the first quarter of 2010.

Cost and Expenses

Cost and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Cost and expenses for the first quarter of 2010 were \$9.0 million, a decrease of 16.4% compared to \$10.8 million for the first quarter of 2009. The decrease is primarily attributable to a \$498,000 decrease in cost of revenue, a \$486,000 decrease in development expense and a \$759,000 decrease in impairment of goodwill expense.

Cost of Revenue. Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue decreased 13.6% to \$3.2 million for the three months ended March 31, 2010, compared to \$3.7 million for the same period in 2009. Direct marketing expenses decreased 15.7% to \$2.4 million for the three months ended March 31, 2010, compared to \$2.9 million for the same period in 2009. The majority of this decline can be attributed to a reduction in inefficient online marketing investments for the Other Affinity and General Market Networks segments. Direct marketing expenses for the Jewish Networks segment decreased 9.9% to \$507,000 in the first quarter of 2010 compared to \$563,000 in the first quarter of 2009. The decrease reflects our shift to more efficient online marketing investments. Direct marketing expenses for the Other Affinity Networks segment decreased 12.8% to \$1.7 million for the first quarter of 2010 compared to \$2.0 million in the first quarter of 2009, reflecting a reduction in inefficient online marketing investments and a shift in brand focus. Direct marketing expenses for the General Market Networks segment decreased 49.1% to \$139,000 in the first quarter of 2010 compared to \$273,000 in the same period in 2009. The decrease reflects management's decision to pursue cost effective online subscriber acquisition marketing campaigns. Direct marketing expenses for the Offline & Other Businesses segment decreased 12.2% to \$43,000 for the first quarter of 2010 compared to \$49,000 for the same period in 2009, reflecting a lower number of hosted events.

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Sales and Marketing. Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel and other associated costs such as public relations. Sales and marketing expenses increased 17.6% to \$1.1 million in the first quarter of 2010 compared to \$921,000 in the first quarter of 2009. The increase can be primarily attributed to higher consulting fees and stock-based compensation expense.

Customer Service. Customer service expenses consist primarily of costs associated with our call centers. Customer service expenses decreased 27.3% to \$396,000 in the first quarter of 2010 compared to \$545,000 in the first quarter of 2009. The expense decrease is primarily due to a reduction in payroll expenses, reflecting the completion of the migration of our customer service group from Beverly Hills, California to Provo, Utah in the fourth quarter of 2009.

Technical Operations. Technical operations expenses consist primarily of the people and systems necessary to support our network, Internet connectivity and other data and communication requirements. Technical operations expenses decreased 7.6% to \$363,000 in the first quarter of 2010 compared to \$393,000 in 2009. The decrease is primarily due to lower salary and benefits expense offset by higher stock-based compensation expense.

Development. Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses decreased 38.4% to \$781,000 in the first quarter of 2010 compared to \$1.3 million in 2009. The decreased costs reflect lower salaries expense and consulting fees.

General and Administrative. General and administrative expenses consist primarily of corporate personnel-related costs, professional fees, and occupancy and other overhead costs. General and administrative expenses were \$2.8 million for the first quarter of 2010 and 2009.

Amortization of Intangible Assets. Amortization expenses consist primarily of amortization of intangible assets related to previous acquisitions, primarily MingleMatch, LDSSingles and HurryDate. Amortization expenses decreased 33.7% to \$122,000 in the first quarter of 2010 compared to \$184,000 in the first quarter of 2009. The decrease reflects the full amortization of select HurryDate intangible assets and a reduction in the value of software associated with a previous acquisition.

Impairment of Goodwill and Other Long-lived Assets. Impairment of goodwill and other long-lived assets expenses primarily represent the write-down of investments in businesses and computer software. Impairment of goodwill and other long-lived assets decreased to \$121,000 in the first quarter of 2010 from \$880,000 in the first quarter of 2009. First quarter 2009 expenses consist primarily of the \$770,000 HurryDate earn-out payment that was concurrently impaired.

Interest Income and Other Expenses, Net. Interest income and other expenses consist primarily of interest income associated with temporary investments in interest bearing accounts and foreign exchange gains and losses related to the intercompany loan with our wholly-owned Israeli subsidiary. Interest income and other expenses reflect income of \$41,000 for the first quarter of 2010 compared to expense of \$492,000 for the same period in 2009. The increase in income is primarily due to a \$422,000 foreign currency translation loss associated with the intercompany loan in the first quarter of 2009 versus a \$74,000 gain in the first quarter of 2010.

Net Income and Net Income Per Share. Net income for the first quarter of 2010 was \$929,000, or \$0.05 per share, compared to \$311,000, or \$0.02 per share for 2009. Net income increased in the first quarter of 2010 primarily due to lower impairment of goodwill and other long-lived assets, lower development expenses, the foreign currency translation gain associated with the intercompany loan, offset by lower revenue net of direct marketing expenses.

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Liquidity and Capital Resources

As of March 31, 2010, we had cash and cash equivalents of \$6.1 million. We have historically financed our operations with internally generated funds.

Net cash provided by operations was \$135,000 for the three months ended March 31, 2010 compared to \$1.2 million for the same period in 2009. Lower revenue, net of direct marketing expenses and a higher working capital requirement in the first quarter of 2010 accounted for the majority of the decrease in net cash provided by operations.

Net cash used in investing activities was \$274,000 in the first quarter of 2010 compared to \$1.2 million in 2009. In the first quarter of 2010, we invested \$274,000 in computer hardware and software. In the first quarter of 2009, we made a HurryDate earn-out payment of \$770,000 and invested \$427,000 of cash in computer hardware and software.

Net cash provided from financing activities was \$15,000 for the first quarter of 2010 compared to \$7,000 for the first quarter of 2009. Cash provided from financing activities was primarily due to the exercise of stock options.

We believe our current cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated cash needs for working capital, planned capital expenditures and contractual obligations for at least the next 12 months. We may be required or find it desirable prior to such time to raise additional funds through bank financing or through the issuance of debt or equity.

Off-Balance Sheet Arrangements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable for a smaller reporting company.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

As of March 31, 2010, our management, with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), performed an evaluation of the effectiveness and the operation of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of March 31, 2010.

(b) Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the quarter ended March 31, 2010 that has materially affected, or is reasonably likely to affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this item is contained in the Notes to the Consolidated Financial Statements contained in this report under Note 7 Commitments and Contingencies Legal Proceedings and is incorporated herein by reference. Also, refer to our Annual Report on Form 10-K for the year ended December 31, 2009 for a further description of litigation and claims.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2009.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

(a) Exhibits:

- 31.1 Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1* Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

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SIGNATURES

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

SPARK NETWORKS, INC.

/s/ Brett Zane
by: Brett A. Zane
Chief Financial Officer
Duly Authorized Officer

Date: May 13, 2010