SPARK NETWORKS INC
Form 10-Q
November 10, 2011

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 September 30, 2011

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)

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

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

The registrant had 20,594,670 shares of common stock, par value $0.001 per share, outstanding as of November 10, 2011.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SPARK NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 14,667	$ 13,901
Restricted cash	926	996
Accounts receivable	962	847
Deferred tax asset current	43	43
Prepaid expenses and other	1,199	911
Total current assets	17,797	16,698
Property and equipment, net	2,670	2,520
Goodwill	8,864	9,156
Intangible assets, net	3,086	3,017
Deferred tax asset non-current	4,882	4,882
Deposits and other assets	490	295
Total assets	$ 37,789	$ 36,568
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 587	$ 1,371
Accrued liabilities	4,337	3,635
Deferred revenue	5,419	4,331
Total current liabilities	10,343	9,337
Deferred tax liability	875	825
Other liabilities non-current	1,036	1,036
Total liabilities	12,254	11,198
Commitments and contingencies (Note 6)		
Stockholders equity:		
Authorized capital stock consists of 100,000,000 shares of common stock, $0.001 par value; issued and outstanding 20,594,670 and 20,587,336 at September 30, 2011 and December 31, 2010, respectively:	22	21
Additional paid-in-capital	52,761	52,020
Accumulated other comprehensive income	699	773
Accumulated deficit	(27,947)	(27,444)
Total stockholders equity	25,535	25,370
Total liabilities and stockholders equity	$ 37,789	$ 36,568

See accompanying notes.

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except per share data)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue	$ 12,677	$ 9,916	$ 35,632	$ 30,742
Cost and expenses:				
Cost of revenue (exclusive of depreciation shown separately below)	7,373	3,206	20,535	9,747
Sales and marketing	923	774	2,660	2,708
Customer service	531	403	1,441	1,181
Technical operations	336	252	1,086	930
Development	643	773	2,067	2,332
General and administrative	2,435	2,316	6,997	7,641
Depreciation	341	242	977	699
Amortization of intangible assets	90	98	281	324
Impairment of long-lived assets and other assets	45		45	121
Total cost and expenses	$ 12,717	$ 8,064	$ 36,089	$ 25,683
Operating (loss) income	(40)	1,852	(457)	5,059
Interest expense (income) and other, net	120	(182)	18	18
Income (loss) before income taxes	(160)	2,034	(475)	5,041
Provision for income taxes	78	808	28	1,963
Net (loss) income	$ (238)	$ 1,226	$ (503)	$ 3,078
Net (loss) income per share basic and diluted	$ (0.01)	$ 0.06	$ (0.02)	$ 0.15
Weighted average shares outstanding basic	20,595	20,587	20,592	20,585
Weighted average shares outstanding diluted	20,595	20,590	20,592	20,588

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Stock-based compensation:				
Cost of revenue	$ 2	$ 3	$ 6	$ 8
Sales and marketing	17	39	65	198
Customer service	0	0	0	1
Technical operations	30	30	88	134
Development	10	14	32	42
General and administrative	124	172	532	857

See accompanying notes.

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net (loss) income	$ (503)	$ 3,078
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Depreciation and amortization	1,258	1,023
Foreign exchange gain on intercompany loan	205	(129)
Impairment of long-lived assets and other assets	45	121
Stock-based compensation	723	1,240
Income from asset received from legal judgment	(247)	
Deferred taxes	49	108
Other	4	(13)
Changes in operating assets and liabilities:		
Accounts receivable	(115)	(10)
Restricted cash	70	74
Prepaid expenses and other assets	(220)	386
Accounts payable and accrued liabilities	(82)	419
Deferred revenue	1,088	(345)
Net cash provided by operating activities	2,275	5,952
Cash flows from investing activities:		
Purchases of property and equipment	(1,179)	(1,023)
Purchases of intangible assets	(352)	(25)
Sale of property and other assets		1,560
Net cash (used in) provided by investing activities	(1,531)	512
Cash flows from financing activities:		
Proceeds from issuance of common stock	22	17
Net cash provided by financing activities	22	17
Net increase in cash	766	6,481
Cash and cash equivalents at beginning of period	13,901	6,223
Cash and cash equivalents at end of period	$ 14,667	$ 12,704
Supplemental disclosure of cash flow information:		
Cash paid for interest	$	$
Cash paid for income taxes	$ 139	$ 294

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.

On December 31, 2010, Spark Networks Limited (SNUK) distributed its shareholdings in each of HurryDate, LLC; MingleMatch, Inc.; Kizmeet, Inc.; SN Holdco, LLC; SN Events, Inc.; Reseaux Spark Canada Ltd. and Spark SocialNet, Inc. by transferring its shares in those companies to Spark Networks, Inc. Spark Networks, Inc. subsequently transferred all of its shares in the same companies to LOV USA, LLC, a newly formed and wholly owned subsidiary of Spark Networks, Inc. SNUK continues to hold all of the shares of Spark Networks (Israel) Limited, VAP AG and JDate Limited. In addition, SNUK now holds all of the shares of Spark Networks USA, LLC, a newly formed subsidiary into which SNUK has transferred all of its United States based assets.

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 on this Form 10-Q 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, 2010. 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, 2010 was derived from the Company s audited financial statements for the year ended December 31, 2010.

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Comprehensive (Loss) Income

Comprehensive (loss) 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 foreign currency translation adjustments. Comprehensive income for each of the periods presented is comprised as follows*:*

(in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net (loss) income	$ (238)	$ 1,226	$ (503)	$ 3,078
Foreign currency translation adjustment, net of taxes	(149)	106	(74)	61
Total comprehensive (loss) income, net of taxes	$ (387)	$ 1,332	$ (577)	$ 3,139

Recent Accounting Pronouncement

In June 2011, the Financial Accounting Standards Board issued guidance on presentation of comprehensive income. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity will be required to present either a continuous statement of net income and other comprehensive income or in two separate but consecutive statements. The new guidance will be effective for the Company beginning January 1, 2012 and will have financial statement presentation changes only.

2. Net (Loss) Income per Share

The Company calculates and presents the net (loss) income per share of both basic and diluted net (loss) income per share. Basic net (loss) income per share is computed by dividing net (loss) 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.

(in thousands except per share data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Income (Loss) per Share of Common Stock Basic				
Net (loss) income applicable to common stock	$ (238)	$ 1,226	$ (503)	$ 3,078
Weighted average shares outstanding-basic	20,595	20,587	20,592	20,585
Basic Net (Loss) Income per Share	**$ (0.01)**	**$ 0.06**	**$ (0.02)**	**$ 0.15**
Income (Loss) per Share of Common Stock Diluted				
Net (loss) income applicable to common stock	$ (238)	$ 1,226	$ (503)	$ 3,078
Weighted average shares outstanding-basic	20,595	20,587	20,592	20,585
Dilutive options using the treasury stock method		3		3
Weighted average shares outstanding diluted	20,595	20,590	20,592	20,588
Diluted Net (Loss) Income per Share	**$ (0.01)**	**$ 0.06**	**$ (0.02)**	**$ 0.15**

The effect of all stock options on diluted weighted average shares outstanding has been excluded from the calculation of (loss) per share for the three and nine months ended September 30, 2011 because it would have been anti-dilutive. Options to purchase approximately 3.1 million shares for the three and nine months ending September 30, 2010, respectively, were not included in the computation of diluted net (loss) income per share because the options were anti-dilutive.

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3. Revolving Credit Facility

As of September 30, 2011, the Company and its wholly-owned subsidiary, Spark Networks USA, LLC, had a $15.0 million revolving credit facility with Bank of America which was entered into on February 14, 2008 with subsequent amendments (the Credit Agreement). The Credit Agreement matures on February 14, 2014. The per annum interest rate under the Credit Agreement is LIBOR, or the Eurodollar rate under certain circumstances, plus 1.75%, 2.00% and 2.50% based upon a financial leverage ratio of less than 1.00, 1.00 to 1.49 and 1.50 and greater, 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. 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 Company is required to maintain a consolidated leverage ratio of no greater than 2.00 to 1.00, and a fixed charge coverage ratio of no less than 1.50 to 1.00. The Company is permitted to repurchase or redeem equity interests or issue dividends of up to $15 million during the first 365 days following February 7, 2011, the date of a subsequent amendment to the Credit Agreement.

On May 11, 2011, the parties executed a Third Amendment to the Credit Agreement (the Amendment). The Amendment requires the Company to maintain a consolidated adjusted EBITDA for each fiscal quarter ending on March 31, 2011 through September 30, 2011 of $400,000; for the quarter ending on December 31, 2011 of $750,000; for each quarter ending on March 31, 2012 through June 30, 2012 of $1,000,000; for each quarter ending on September 30, 2012 through December 31, 2012 of $1,500,000; and for each quarter ending on or after March 31, 2013 of $2,000,000. In addition, the Amendment requires the Company to maintain a trailing twelve month contribution level of $20,000,000 from its Jewish Networks segment for each fiscal quarter ending on or after March 31, 2011.

The Company was compliant with the Credit Agreement s customary affirmative and negative covenants, as of September 30, 2011.

At September 30, 2011, there was no outstanding amount under the Credit Agreement. In connection with the original Credit Agreement and the Amendment, the Company paid deferred financing costs of approximately $446,000 and $80,000, respectively. Costs associated with both the original Credit Agreement and the Amendment were included in prepaid expenses and other, and deposits and other assets. The deferred financing costs are amortized to interest expense in the Consolidated Statements of Operations over the full term of the Credit Agreement. Amortization expense for the deferred financing costs for the three and nine months ended September 30, 2011 were $4,000 and $53,000, respectively. The deferred financing costs for the three and nine months ended September 30, 2010 were $35,000 and $37,000, respectively.

4. Stockholders Equity

Re-Pricing of Employees Options

In 2009, the Company offered to re-price options for certain employees. These employees could surrender their existing options in exchange for a like number of options with a new grant date, a lower exercise price, a lower number of vested options and a modified vesting schedule. The exchange of options was treated as a synthetic re-pricing, which includes a cancellation and replacement of equity instruments. The incremental expense was approximately $1 million and is being recognized over the four year vesting term of the newly issued options. The incremental expense recognized for the three months ended September 30, 2011 and 2010 was $43,000 and $43,000, respectively. The incremental expense recognized for the nine months ended September 30, 2011 and 2010 was $129,000 and $296,000, respectively.

Employee Stock Option Plans

On July 9, 2007, pursuant to the completion of the Scheme of Arrangement, the Company adopted the Spark Networks, Inc. 2007 Omnibus Incentive Plan (the 2007 Plan) authorizing and reserving 2.5 million options. In connection with the Company s Scheme of Arrangement, the 2004 Share Option Plan was frozen; however, all outstanding options previously granted thereunder continue in full force and effect.

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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 September 30, 2011, total unrecognized compensation cost related to unvested stock options was $1.4 million. This cost is expected to be recognized over a weighted-average period of two years. The following table describes option activity for the nine months ended September 30, 2011:

	Number of Shares (in thousands)	Weighted Average Price Per Share
Outstanding at December 31, 2010	3,364	$ 3.12
Granted	55	3.20
Exercised		
Forfeited	(12)	2.92
Expired		
Outstanding at March 31, 2011	3,407	$ 3.11
Granted	603	3.18
Exercised	(7)	2.96
Forfeited	(449)	3.00
Expired	(6)	3.00
Outstanding at June 30, 2011	3,548	$ 3.13
Granted	20	3.45
Exercised		
Forfeited		
Expired	(3)	3.00
Outstanding at September 30, 2011	3,565	$ 3.14

Stockholder Rights Plan

In July 2007, the Company adopted 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.

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5. Segment Information

The Company has four operating segments: (1) 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; (2) 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; (3) 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 (4) Offline & Other Businesses, which consists of revenue generated from offline activities, HurryDate events and subscriptions to HurryDate.com.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2011**	**2010**	**2011**	**2010**
Revenue				
Jewish Networks	$ 6,724	$ 6,766	$ 20,354	$ 20,509
Other Affinity Networks	5,715	2,744	14,140	8,496
General Market Networks	127	264	471	932
Offline & Other Businesses	111	142	667	805
Total	**$ 12,677**	**$ 9,916**	**$ 35,632**	**$ 30,742**
Direct Marketing				
Jewish Networks	$ 936	$ 696	$ 2,460	$ 1,735
Other Affinity Networks	5,526	1,601	14,819	4,855
General Market Networks	18	121	347	407
Offline & Other Businesses	32	39	463	473
Total	**$ 6,512**	**$ 2,457**	**$ 18,089**	**$ 7,470**
Unallocated operating expenses	6,205	5,607	18,000	18,213
Operating (loss) income	**$ (40)**	**$ 1,852**	**$ (457)**	**$ 5,059**

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.

6. Commitments and Contingencies

Legal Proceedings

Please refer to our Annual Report on Form 10-K for the year ended December 31, 2010 and subsequent Quarterly Reports on Form 10-Q for a description of litigation and claims.

ISYSTEMS v. Spark Networks, Inc. et al.

On July 11, 2008, ISYSTEMS initiated a lawsuit against Spark Networks, Inc. and Spark Networks Limited (collectively, Spark Networks) and other parties in the United States District Court, Northern District of Texas, Dallas Division. The lawsuit was filed in response to an arbitration award ordering the transfer of the domain name, JDATE.NET, to Spark Networks Limited from ISYSTEMS. Spark Networks was apprised of the lawsuit after ISYSTEMS unsuccessfully attempted to utilize the filing of the lawsuit to prevent the domain transfer to Spark Networks Limited. On December 1, 2008, Spark Networks filed a Motion to Dismiss the Complaint, or, Alternatively, for Summary Judgment. On

September 10, 2009, the Court granted Spark Networks motion and dismissed the case with prejudice. On September 22, 2009, ISYSTEMS filed a motion to vacate the order dismissing the action and requesting leave to amend its complaint. On October 26, 2009, the Court granted ISYSTEMS motion and ISYSTEMS filed its Amended Complaint on November 25, 2009. On January 19, 2010, Spark Networks filed a Motion to Dismiss the Amended Complaint, or Alternatively, for Summary Judgment. The court granted Spark Networks Motion to Dismiss on June 28, 2010 and entered a judgment in favor of Spark Networks. On July 25, 2010, ISYSTEMS filed a motion to vacate the order granting the motion to dismiss, which was denied by the court on August 11, 2010. On September 10, 2010, ISYSTEMS filed a notice of appeal of the district court s order and judgment to the United States Court of Appeals for the Fifth Circuit. On June 13, 2011, the United States Court of Appeals for the Fifth Circuit issued its opinion affirming the District Court s judgment. On June 29, 2011, ISYSTEMS filed a Petition for Rehearing with the United States Court of Appeals for the Fifth Circuit which was granted. Trial is scheduled for April 17, 2012.

Spark Networks USA, LLC v. Humor Rainbow, Inc. and Zoosk, Inc.

On February 16, 2011, Spark Networks, Inc. s indirect subsidiary, Spark Networks USA, LLC, filed a complaint against Humor Rainbow, Inc., in the United States District Court for the Central District of California, Southern Division. On March 4, 2011, Spark Networks USA, LLC filed an amended complaint with the Court adding defendants Zoosk, Inc. and Embrace, Inc. The complaint alleges that, among other things, the defendants have infringed and continue to infringe on a patent owned by Spark Networks USA, LLC. On May 6, 2011, Spark Networks USA, LLC filed a Notice Of Dismissal Without Prejudice with the court in regards to the claim against Embrace, Inc. On September 13, 2011, Humor Rainbow was dismissed from the case following a settlement. On November 9, 2011, Zoosk was dismissed from the case following a settlement.

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.

7. Income on Possession of Assets

In the third quarter of 2011, the Company became the record title owner of real property purchased in a sheriff s sale to partially satisfy the Company s outstanding judgment against Will Knedlik. The Company recorded other income of $247,000 in the Interest expense (income) and other, net line item on the Consolidated Statements of Operations and recorded the asset as Deposits and Other Assets on the Consolidated Balance Sheets. The Company plans to sell the property and it was recorded at fair value less the anticipated cost of sale.

8. Impairment of Long-lived Assets

In the nine months ending September 30, 2011 and 2010, the Company impaired approximately $45,000 and $121,000 of capitalized software development costs when it was determined that certain web-based products failed to perform to Company standards.

9. Income Taxes

Provision for income taxes for the nine months ended September 30, 2011 consists primarily of a $90,000 tax benefit related to our US operations and a $118,000 deferred tax expense related to an increase in the deferred tax liability associated with our Israeli subsidiary s tax deductible goodwill amortization. No income tax benefit has been recorded on losses generated by our Israeli subsidiary as management cannot conclude that it is more likely than not that such tax benefits will be realized. As a result, for the Israeli subsidiary, the Company has recorded a net tax expense despite losses generated which results in a negative effective tax rate.

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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, 2010 (the 2010 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 2010 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 nine months ended September 30, 2011, as compared to those policies disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Segment Reporting

For segment information, please refer to Note 5 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Average Paying Subscribers				
Jewish Networks	88,976	89,792	90,205	90,694
Other Affinity Networks	113,972	62,026	97,311	64,744
General Market Networks	2,702	5,888	3,465	