Tree.com, Inc.
Form DEF 14A
April 28, 2011

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

SCHEDULE 14A
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material under §240.14a-12

TREE.COM, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

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(2) Form, Schedule or Registration Statement No.:

N/A

(3) Filing Party:

N/A

(4) Date Filed:

N/A

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11115 Rushmore Drive, Charlotte, North Carolina 28277

Dear Stockholder:

You are invited to attend the 2011 Annual Meeting of Stockholders of Tree.com, Inc., which will be held on Wednesday, June 8, 2011, 11:00 a.m., local time, at Tree.com's corporate headquarters at 11115 Rushmore Drive, Charlotte, North Carolina 28277. At the Annual Meeting, stockholders will be asked to vote on four proposals, which are described in detail in the notice of meeting on the following page and the accompanying Proxy Statement.

We will be using the "Notice and Access" method of providing proxy materials to you via the Internet. We believe that this process should provide you with a convenient and quick way to access your proxy materials and vote your shares, while allowing us to conserve natural resources and reduce the costs of printing and distributing the proxy materials. On or about April 28, 2011, we will mail to our stockholders a Notice of Internet Availability of Proxy Materials containing instructions on how to access our Proxy Statement and our 2010 Annual Report to Stockholders and vote electronically via the Internet. The Notice also contains instructions on how to receive a paper copy of the proxy materials.

It is important that your shares be represented and voted at the Annual Meeting regardless of the size of your holdings. Whether or not you plan to attend the meeting, please vote electronically via the Internet or by telephone, or, if you request paper copies of the proxy materials, please complete, sign, date and return the accompanying proxy in the postage-paid envelope provided. See "How Do I Vote?" in the Proxy Statement for more details. Voting electronically or returning your proxy does NOT deprive you of your right to attend the meeting and to vote your shares in person for the matters acted upon at the meeting.

I look forward to greeting those of you who will be able to attend the meeting.

Sincerely,

Douglas Lebda
Chairman and Chief Executive Officer

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11115 Rushmore Drive, Charlotte, North Carolina 28277

NOTICE OF 2011 ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders:

Tree.com, Inc. ("Tree.com" or the "Company") is providing this Proxy Statement to holders of our common stock in connection with the solicitation of proxies by our Board of Directors for use at the 2011 Annual Meeting of Stockholders (the "Annual Meeting") to be held on Wednesday, June 8, 2011, at 11:00 a.m., local time, at our corporate headquarters at 11115 Rushmore Drive, Charlotte, North Carolina 28277. At the Annual Meeting, stockholders will be asked:

1. to elect seven members of our Board of Directors, each to hold office for a one-year term ending on the date of the next succeeding annual meeting of stockholders or until such director's successor shall have been duly elected and qualified (or, if earlier, such director's removal or resignation from our Board of Directors);

2. to consider and provide an advisory (non-binding) "Say on Pay" vote on the compensation of our named executive officers, as described in the accompanying Proxy Statement;

3. to consider and provide an advisory (non-binding) "Say on Frequency" vote on how frequently (i.e., every one, two or three years) you prefer that we conduct an advisory vote of stockholders on the compensation of our named executive officers;

4. to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the 2011 fiscal year; and

5. to transact such other business as may properly come before the meeting and any related adjournments or postponements.

Our Board of Directors has set April 11, 2011 as the record date for the Annual Meeting. This means that holders of record of our common stock at the close of business on that date are entitled to receive notice of the Annual Meeting and to vote their shares at the Annual Meeting and any related adjournments or postponements.

Only stockholders and persons holding proxies from stockholders may attend the Annual Meeting. If your shares are registered in your name, you should bring a form of photo identification to the Annual Meeting. If your shares are held in the name of a broker, trust, bank or other nominee, you will need to bring a proxy or letter from that broker, trust, bank or other nominee that confirms you are the beneficial owner of those shares, together with a form of photo identification. Cameras, recording devices and other electronic devices will not be permitted at the Annual Meeting.

Important Notice Regarding the Availability of Proxy Materials for the 2011 Annual Meeting of Stockholders to be held on June 8, 2011.

Copies of the Proxy Statement and of our annual report for the fiscal year ended December 31, 2010 are available by visiting the following website: *http://bnymellon.mobular.net/bnymellon/tree.*

By Order Of The Board Of Directors,

Douglas Lebda
Chairman and Chief Executive Officer

April 28, 2011

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PROXY STATEMENT FOR THE 2011 ANNUAL MEETING OF STOCKHOLDERS

We are providing these proxy materials in connection with Tree.com's 2011 Annual Meeting of Stockholders. The Notice of Internet Availability of Proxy Materials, this Proxy Statement, any accompanying proxy card or voting instruction card and our 2010 Annual Report to Stockholders were first made available to stockholders on or about April 28, 2011. This Proxy Statement contains important information for you to consider when deciding how to vote on the matters brought before the Annual Meeting. Please read it carefully.

QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETING AND VOTING

Q:

Who is entitled to vote at the Annual Meeting?

A:

Holders of Tree.com common stock at the close of business on April 11, 2011, the record date for the Annual Meeting established by our Board of Directors (the "Board"), are entitled to receive notice of the Annual Meeting, the Notice of Internet Availability of Proxy Materials (the "Notice of Internet Availability") and to vote their shares at the Annual Meeting and any related adjournments or postponements. The Notice of Internet Availability, Notice of Annual Meeting, Proxy Statement and form of proxy are first expected to be made available to stockholders on or about April 28, 2011.

As of the close of business on the record date, there were 10,988,799 shares of our common stock outstanding and entitled to vote. Holders of our common stock are entitled to one vote per share.

Q:

Why did I receive a notice in the mail regarding the Internet availability of proxy materials instead of a paper copy of proxy materials?

A:

The United States Securities and Exchange Commission (the "SEC") approved "Notice and Access" rules relating to the delivery of proxy materials over the Internet. These rules permit us to furnish proxy materials, including this Proxy Statement and our 2010 Annual Report to Stockholders, to our stockholders by providing access to such documents on the Internet instead of mailing printed copies. Most stockholders will not receive printed copies of the proxy materials unless they request them. Instead, the Notice of Internet Availability, which was mailed to most of our stockholders, will instruct you as to how you may access and review all of the proxy materials on the Internet. The Notice also instructs you as to how you may submit your proxy on the Internet. If you would like to receive a paper or email copy of our proxy materials, you should follow the instructions for requesting such materials in the Notice of Internet Availability.

Q:

Can I vote my shares by filling out and returning the Notice of Internet Availability?

A.

No. The Notice of Internet Availability identifies the items to be voted on at the Annual Meeting, but you cannot vote by marking the Notice of Internet Availability and returning it.

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The Notice of Internet Availability provides instructions on how to vote by Internet or telephone, by requesting and returning a paper proxy card or voting instruction card, or by submitting a ballot in person at the Annual Meeting.

Q:

What is the difference between a stockholder of record and a stockholder who holds stock in street name?

A:

If your shares are registered in your name, you are a stockholder of record. If your shares are held in the name of your broker, bank or another holder of record, these shares are held in "street name."

You may examine a list of the stockholders of record as of the close of business on April 11, 2011 for any purpose germane to the Annual Meeting during normal business hours during the 10-day period preceding the date of the meeting at our corporate headquarters at 11115 Rushmore Drive, Charlotte, North Carolina 28277. This list will also be made available at the Annual Meeting.

Q:

What shares are included on the enclosed proxy card?

A:

If you are a stockholder of record only, you will receive the Notice of Internet Availability or these proxy materials from BNY Mellon Shareowner Services for all Tree.com shares that you hold directly. If you have requested printed proxy materials, we have enclosed a proxy card for you to use. If you hold our shares in street name through one or more banks, brokers and/or other holders of record, you will receive the Notice of Internet Availability or these proxy materials, together with voting instructions and information regarding the consolidation of your votes, from the third party or parties through which you hold your shares. If you are a stockholder of record and hold additional Tree.com shares in street name, you will receive the Notice of Internet Availability or these proxy materials from BNY Mellon Shareowner Services and the third party or parties through which your shares are held. If you requested printed proxy materials, your broker, bank or nominee has enclosed a voting instruction card for you to use in directing the broker, bank or nominee regarding how to vote your shares.

Q:

What are the quorum requirements for the Annual Meeting?

A:

The presence in person or by proxy of holders having a majority of the total votes entitled to be cast by holders of our common stock at the Annual Meeting constitutes a quorum. Shares of our common stock are counted as present at the Annual Meeting for purposes of determining whether there is a quorum, if you are present and vote in person at the Annual Meeting or by telephone or on the Internet or a proxy card has been properly submitted by you or on your behalf at the Annual Meeting, without regard to whether the proxy is marked as casting a vote or abstaining.

Abstaining votes and broker non-votes are counted for purposes of establishing a quorum, but are not counted in the election of directors and therefore have no effect on the election. In a vote on the other proposals to be considered at the Annual Meeting, an abstaining vote will have the same effect as a vote against the proposals, but a broker non-vote will not be included in the tabulation of the voting results and therefore will not affect the outcome of the vote. A broker non-vote occurs when a broker or other nominee submits a proxy card with respect to shares of common stock held in a fiduciary capacity (typically referred to as being held in "street name"), but declines to vote on a particular matter because the broker or nominee has not received voting instructions from the beneficial owner or the persons entitled to vote those shares and for which the broker or nominee does not have discretionary voting power under rules applicable to broker-dealers.

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Q:
What matters will the stockholders vote on at the Annual Meeting?

The stockholders will vote on the following proposals:

Proposal 1 to elect seven members of our Board of Directors, each to hold office for a one-year term ending on the date of the next succeeding annual meeting of stockholders or until such director's successor shall have been duly elected and qualified (or, if earlier, such director's removal or resignation from our Board of Directors);

Proposal 2 to consider and provide an advisory (non-binding) "Say on Pay" vote on the compensation of our named executive officers, as described in this Proxy Statement;

Proposal 3 to consider and provide an advisory (non-binding) "Say on Frequency" vote on how frequently (i.e., every one, two or three years) you prefer that we conduct an advisory vote of stockholders on the compensation of our named executive officers;

Proposal 4 to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the 2011 fiscal year; and

to transact such other business as may properly come before the Annual Meeting and any related adjournments or postponements.

Q:
What are my voting choices when voting for director nominees and what votes are required to elect directors to the Board of Directors?

A:
In the vote on the election of director nominees, you may vote in favor of all nominees, withhold votes as to all nominees or vote in favor of and withhold votes as to specific nominees.

The election of each of Peter Horan, W. Mac Lackey, Douglas Lebda, Joseph Levin, Patrick McCrory, Lance Melber and Steven Ozonian as directors requires the affirmative vote of a plurality of the total number of votes cast by the holders of shares of our common stock.

The Board recommends that stockholders vote **FOR** the election of each of its nominees for director named above.

Q:
What are my voting choices when participating in the advisory "Say on Pay" vote on the approval of compensation of the Company's named executive officers?

A.
In the advisory Say on Pay vote on the approval of compensation of the Company's named executive officers, as described in the Compensation Discussion and Analysis ("CD&A") and tabular disclosures contained in this Proxy Statement, you may vote in favor of approval, vote against approval or abstain from voting.

The approval of the advisory Say on Pay proposal requires the affirmative vote of a majority of the total number of votes cast at the Annual Meeting by the holders of shares of our common stock. Since the required vote is advisory, the result of the vote is not binding upon the Board or its Compensation Committee. However, we value the opinions of our stockholders, and we will consider the outcome of the vote when determining future executive compensation arrangements.

The Board recommends that the stockholders vote **FOR** the approval of compensation of the Company's named executive officers.

Q:

What are my voting choices when participating in the advisory "Say on Frequency" vote on the frequency of the advisory vote on approval of compensation of the Company's named executive officers?

A.

In the advisory Say on Frequency vote, you may vote in favor of an advisory vote every one year, every two years, every three years or abstain from voting.

The option, if any, that receives the affirmative vote of a majority of the total number of votes cast at the Annual Meeting by the holders of shares of our common stock will be the frequency for the advisory Say on Frequency vote that has been selected by our stockholders. Since the required vote is advisory, the result of the vote is not binding upon the Board. However, we value the opinions of our stockholders, and we will consider the outcome of the vote when determining the frequency of future advisory votes on approval of our executive compensation arrangements.

The Board recommends that the stockholders vote **FOR** a frequency of every THREE years.

Q:

What are my voting choices when voting on the ratification of the appointment of Deloitte & Touche LLP as Tree.com's independent registered public accounting firm and what votes are required to ratify such appointment?

A.

In the vote on the ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2011, you may vote in favor of the ratification, vote against the ratification or abstain from voting on the ratification.

The ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2011 requires the affirmative vote of a majority of the total number of votes cast at the Annual Meeting by the holders of shares of our common stock.

The Board recommends that the stockholders vote **FOR** ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2011.

Q:

Could other matters be decided at the Annual Meeting?

A:

As of the date of the filing of this Proxy Statement, we are not aware of any matters to be raised at the Annual Meeting other than those referred to in this Proxy Statement.

If other matters are properly presented at the Annual Meeting for consideration, our two officers who have been designated as proxies for the Annual Meeting, James Ipock and Erin Eklund, will have the discretion to vote on those matters for stockholders who have returned their proxy.

Q:

If I hold my shares in street name through my broker, will my broker vote these shares for me?

A:

If you hold your shares in street name, you must provide your broker, bank or other nominee with instructions in order to vote these shares. To do so, you should follow the directions regarding voting instructions provided to you by your bank, broker or other nominee. If your bank, broker or nominee holds your shares in its name and you do not instruct them how to vote, they will have discretion to vote your shares on routine matters, including the ratification of the selection of the Company's independent public accounting firm (Proposal 4). However, they will not have discretion to vote on non-routine matters without direction from you, including the election of directors (Proposal 1), the advisory Say on Pay vote (Proposal 2) and the advisory Say on Frequency vote (Proposal 3). Accordingly, broker non-votes will not occur at the Annual Meeting in connection with Proposal 4. Broker non-votes may occur in connection with Proposals 1, 2 and 3 at the Annual Meeting; however, broker non-votes will have no effect on the outcome of those proposals.

Q:

What happens if I abstain?

A:

Abstentions are counted for purposes of determining whether there is a quorum and, with respect to all proposals other than the election of directors (Proposal 1), will have the same effect as a vote against the proposal.

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Q: **Can I change my vote?**

A: Yes. If you are a stockholder of record, you may change your vote or revoke your proxy at any time before the vote at the Annual Meeting by:

- delivering to BNY Mellon Shareowner Services a written notice, bearing a date later than your proxy, stating that you revoke the proxy;
- submitting a later-dated proxy relating to the same shares by mail, telephone or the Internet prior to the vote at the Annual Meeting; or
- attending the Annual Meeting and voting in person (although attendance at the Annual Meeting will not, by itself, revoke a proxy).

You should send any written notice or a new proxy card to Tree.com c/o BNY Mellon Shareowner Services at the following address: BNY Mellon Shareowner Services, P.O. Box 3550, South Hackensack, NJ 07606-9250, or follow the instructions provided on your proxy card to submit a proxy by telephone or via the Internet. You may request a new proxy card by calling BNY Mellon Shareowner Services, Proxy Processing at 1-877-296-3711 (toll-free).

Q: **What if I do not specify a choice for a proposal when returning a proxy?**

A: If you do not give specific instructions, proxies that are signed and returned will be voted **FOR** the election of all director nominees named in the Proxy Statement, approval of the advisory Say on Pay vote on compensation of our named executive officers, approval of the advisory Say on Frequency vote on executive compensation every THREE years and the ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2011.

Q: **How are proxies solicited and what is the cost?**

A: We will bear all expenses incurred in connection with the solicitation of proxies. In addition to solicitation by mail, our directors, officers and employees may solicit proxies from stockholders by telephone, letter, facsimile or in person. Following the original mailing of the Notice of Internet Availability, we will request brokers, custodians, nominees and other record holders to forward their own notice and, upon request, to forward copies of the Proxy Statement and related soliciting materials to persons for whom they hold shares of our common stock and to request authority for the exercise of proxies. In such cases, upon the request of the record holders, we will reimburse such holders for their reasonable expenses.

Q: **What should I do if I have questions regarding the Annual Meeting?**

A: If you have any questions about how to cast your vote for the Annual Meeting or would like copies of any of the documents referred to in this Proxy Statement, you should call BNY Mellon Shareowner Services, Proxy Processing at 1-877-296-3711 (toll-free).

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HOW DO I VOTE?

Your vote is important. You may vote on the Internet, by telephone, by mail or by attending the Annual Meeting and voting by ballot, all as described below. If you vote by telephone or on the Internet, you do not need to return your Notice, proxy card or voting instruction card. Telephone and Internet voting facilities are available now and will be available 24 hours a day until 11:59 p.m., Eastern Time, on June 7, 2011.

Vote on the Internet

If you have Internet access, you may submit your proxy by following the instructions provided in the Notice of Internet Availability, or if you request printed proxy materials, by following the instructions provided with your proxy materials and on your proxy card or voting instruction card. If you vote on the Internet, you can also request electronic delivery of future proxy materials.

Vote by Telephone

You can also vote by telephone by following the instructions provided on the Internet voting site, or if you requested printed proxy materials, by following the instructions provided with your proxy materials and on your proxy card or voting instruction card. Easy-to-follow voice prompts allow you to vote your shares and confirm that your instructions have been properly recorded.

Vote by Mail

If you elected to receive printed proxy materials by mail, you may choose to vote by mail by marking your proxy card or voting instruction card, dating and signing it, and returning it to Tree.com c/o BNY Mellon Shareowner Services in the postage-paid envelope provided. If the envelope is missing, please mail your completed proxy card or voting instruction card to Tree.com c/o BNY Mellon Shareowner Services at the following address: BNY Mellon Shareowner Services, P.O. Box 3550, South Hackensack, NJ 07606-9250. Please allow sufficient time for mailing if you decide to vote by mail.

Vote at the Annual Meeting

The method or timing of your vote will not limit your right to vote at the Annual Meeting if you attend the Annual Meeting and vote in person. However, if your shares are held in the name of a bank, broker or other nominee, you must obtain a legal proxy, executed in your favor, from the holder of record to be able to vote at the Annual Meeting. You should allow yourself enough time prior to the Annual Meeting to obtain this proxy from the holder of record.

Street name holders may submit a proxy by telephone or the Internet if their bank or broker makes these methods available, in which case the bank or broker will enclose related instructions with this Proxy Statement. If you submit a proxy by telephone or via the Internet you should not return your proxy card. If you hold your shares through a bank, broker or other nominee follow the voting instructions you receive from your bank, broker or other nominee.

PROPOSAL 1 ELECTION OF DIRECTORS

Proposal

At the upcoming Annual Meeting, a board of seven directors will be elected, each to hold office until the next succeeding annual meeting of stockholders or until such director's successor shall have been duly elected and qualified (or, if earlier, such director's removal or resignation from our Board of Directors). Information concerning all director nominees appears below. Although management does not anticipate that any of the persons named below will be unable or unwilling to stand for election, in the event of such an occurrence, proxies may be voted for a substitute designated by the Board.

The Board recommends that stockholders vote FOR the election of each of the following persons (the "Nominees"):

**PETER HORAN, W. MAC LACKEY, DOUGLAS LEBDA, JOSEPH LEVIN,
PATRICK MCCRORY, LANCE MELBER, STEVEN OZONIAN**

Information Concerning Director Nominees

Background information about the Nominees, as well as information regarding additional experience, qualifications, attributes or skills that led the Board to conclude that the Nominee should serve on the Board, is set forth below.

Peter Horan, age 56, has served as a member of our Board of Directors since August 2008. Mr. Horan has also previously served as a member of our Audit Committee. Mr. Horan is currently Executive Chairman of Halogen Media Group. He previously served as Chairman of Goodmail Systems, Inc. from February 2010 to February 2011 and served as Chief Executive Officer of that company from May 2008 until February 2010. Prior to that, Mr. Horan served as Chief Executive Officer of IAC/InterActiveCorp ("IAC") Media & Advertising from January 2007 to June 2008. Mr. Horan also served as Chief Executive Officer of AllBusiness.com, Inc., About.com, Inc. and DevX.com, Inc. Additionally, Mr. Horan served in senior management roles at International Data Group and Computerworld. Prior to that, Mr. Horan spent more than 15 years in senior account management roles at leading advertising agencies, including BBDO and Ogilvy & Mather. Mr. Horan is also a member of the Board of Directors of Merchant Circle, a private company.

Mr. Horan brings to the Board his diverse executive and management experience as well as a significant knowledge of the Internet media and advertising industries. He also provides the Board with financial reporting expertise and a unique perspective from his experience in account management positions in the advertising industry.

W. Mac Lackey, age 40, has served as a member of our Board of Directors since October 2008. Mr. Lackey is also Chair of our Audit Committee and a member of our Compensation Committee. Mr. Lackey has served as a Founder and Managing Director of BlackHawk Capital Management, LLC since June 2007 and as a Founder of Mountain Khakis, LLC since September 2003. Mr. Lackey previously served as Chief Executive Officer and Chairman of the Board of ettain group, Inc. Prior to that, Mr. Lackey served as President and Chief Executive Officer of TeamTalk Media Group, PLC's North American Operations. Before holding such positions, Mr. Lackey co-founded The Internetsoccer Network and co-founded and operated inTouch Interactive.

Mr. Lackey's extensive business, managerial, executive and leadership experience in a variety of industries including Internet companies particularly qualifies him for service on the Board. He also brings a valuable entrepreneurial perspective from his experience as the founder of several businesses.

Douglas Lebda, age 41, is our Chairman, Chief Executive Officer and a member of our Board of Directors and has served in such capacities since January 2008. Previously, Mr. Lebda served as President and Chief Operating Officer of IAC from January 2006 to August 2008, when the Company was spun-off from IAC. Prior to that, Mr. Lebda served in roles as Chief Executive Officer, President

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and Chairman of the Board of LendingTree, LLC, which he founded in June 1996. Before founding LendingTree, Mr. Lebda worked as an auditor and consultant for PriceWaterhouseCoopers. Mr. Lebda is a member of the Board of Directors of Eastman Kodak.

Mr. Lebda, the founder of LendingTree, LLC, provides the Board with a vital understanding and appreciation of the Company's business and history. His experience as Chief Operating Officer of IAC, a large conglomerate of Internet companies, as well as his financial and accounting expertise, also qualify him to serve on the Board. Mr. Lebda also brings to the Board a valuable understanding of the role played by directors of publicly-held companies due to his service on the board of Eastman Kodak.

Joseph Levin, age 31, has served as a member of our Board of Directors since August 2008. Mr. Levin is also a member of our Audit Committee. Mr. Levin has served as Chief Executive Officer of Mindspark Interactive Network, a subsidiary of IAC, since November 2009. Previously Mr. Levin served as Senior Vice President, Mergers & Acquisitions and Finance for IAC from December 2007 to November 2009. Since joining IAC in 2003, Mr. Levin has worked in various capacities including Strategic Planning, M&A and Finance. Prior to joining IAC, Mr. Levin worked in the Technology Mergers & Acquisitions group for Credit Suisse First Boston (now Credit Suisse). Mr. Levin is a member of the Boards of Directors of The Active Network and Merchant Circle, both private companies.

Mr. Levin's background in mergers and acquisitions in the technology industry provides the Board with a valuable perspective. He also brings to the Board his strategic planning and finance experience. Mr. Levin's service on the board of directors of an online community marketing company provides him with relevant business expertise.

Patrick McCrory, age 54, has served as a member of our Board of Directors since January 2009. Mr. McCrory is also a member of our Audit, Compensation and Nominating Committees. Mr. McCrory is a partner of McCrory & Company, a sales consulting company and, since January 2010, has served as Senior Director of Strategic Initiatives at Moore & Van Allen PLLC, a law firm. Previously, Mr. McCrory served as Mayor of Charlotte, North Carolina from 1995 until 2009. Mr. McCrory has had an extensive private sector career serving 29 years with Duke Energy Corporation in various management positions. Mr. McCrory is a member of the Board of Directors of Kewaunee Scientific Group.

Mr. McCrory brings to the Board his proven leadership and managerial capabilities. He also provides the Board with a deep knowledge of governmental affairs acquired through his background in government.

Lance Melber, age 48, has served as a member of our Board of Directors since August 2008. Mr. Melber is also a member of our Nominating Committee and Chair of the Compensation Committee. Mr. Melber served as Executive Vice President and a Director of Archer Technologies, a software company, from August 2008 to January 2010. Mr. Melber served as President of Capital One Home Loans from early 2005 until March 2008. Prior to that, Mr. Melber founded eSmartloan.com and served as its Chief Executive Officer from 2001 until it was acquired by Capital One in early 2005. Prior to founding eSmartloan.com, Mr. Melber served as the Managing Director of Oneloan.com working for First Horizon National Corp.

Mr. Melber is qualified for service on the Board because of his valuable mortgage industry expertise. He also provides an entrepreneurial perspective acquired through his experience as founder of an internet lender as well as extensive business, managerial and executive experience.

Steven Ozonian, age 55, previously served as a member of our Board of Directors from August 2008 to November 2010. He resigned from the Board effective November 1, 2010 to join the Company as Chief Executive Officer of our proprietary full service real estate brokerage business known as RealEstate.com, REALTORS®. On March 15, 2011, the Company announced that it had finalized a plan to close all of the field offices of RealEstate.com and, on March 31, 2011, Mr. Ozonian resigned from his position as Chief Executive Officer of the division. Prior to his employment at the Company, Mr. Ozonian served as the Executive Chairman of Global Mobility Solutions from 2005 to 2010. Mr. Ozonian has held other high level positions in the homeownership industry including Chairman and CEO of Prudential's real estate and related businesses, CEO of Realtor.com and National Homeownership Executive for Bank of America.

Mr. Ozonian provides the Board with valuable real estate industry and mergers and acquisitions expertise. He has significant executive experience and a deep understanding of the functions of a board of directors acquired through service as chairman of other corporations.

All Nominees have been recommended by the Nominating Committee. Except for Mr. Ozonian, all Nominees are current directors standing for re-election. As a former director and executive officer of the Company, Mr. Ozonian was identified as a director candidate by the Nominating Committee.

Corporate Governance

Director Independence. Under the Listing Rules of the NASDAQ Stock Market, the Board has a responsibility to make an affirmative determination that those members of the Board that serve as independent directors do not have any relationships with the Company and its businesses that would impair their independence. In connection with these determinations, the Board reviews information regarding transactions, relationships and arrangements involving the Company and its businesses and each director that it deems relevant to independence, including those required by the Listing Rules of the NASDAQ Stock Market.

The Board has determined that each of Messrs. Lackey, McCrory and Melber are independent directors within the meaning of the applicable NASDAQ standards. In addition, the Board determined that Mr. Horan will become independent shortly prior to the date of the Annual Meeting. Mr. Horan has not previously been deemed independent because he served as an executive officer of IAC prior to our August 2008 spin-off from IAC. Mr. Horan's employment with IAC ceased on June 7, 2008. The Board determined that Mr. Horan will become eligible to serve as an independent director of the Board after June 7, 2011 because a sufficient period of time will have elapsed since the termination of his employment as an executive officer of IAC to satisfy the independence requirements under the NASDAQ listing standards.

When assessing Mr. McCrory's independence, the Board considered the fact that Mr. McCrory's employer was engaged to provide legal and consulting services to the Company in early 2011. The Board determined that these services did not have an impact on Mr. McCrory's independence, due to various factors, including Mr. McCrory's position at the service provider and the dollar value of the legal and consulting services to be provided.

Director Nominations. Our Nominating Committee considers and recommends to our Board candidates for election to the Board and nominees for committee memberships and committee chairs. Each member of the Nominating Committee participates in the review and discussion of director candidates. In addition, directors who are not on the Nominating Committee may meet with and evaluate the suitability of candidates. The full Board makes final determinations on director nominees.

The Board does not have specific requirements for eligibility to serve as a director of Tree.com. However, in evaluating candidates, regardless of how recommended, the Board considers whether the professional and personal ethics and values of the candidate are consistent with ours, whether the candidate's experience and expertise would be beneficial to the Board in rendering its service to us, whether the candidate is willing and able to devote the necessary time and energy to the work of the Board and whether the candidate is prepared and qualified to represent the best interests of our stockholders.

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In evaluating director candidates, the Chair of the Nominating Committee and other committee members may conduct interviews with certain candidates and make recommendations to the committee. Other members of the Board may also conduct interviews with director candidates upon request, and the Nominating Committee may retain, at its discretion, third-party consultants to assess the skills and qualifications of the candidates. Although the Board does not have a specific policy with respect to diversity, the Nominating Committee considers the extent to which potential candidates possess sufficiently diverse skill sets and diversity characteristics that would contribute to the Board's overall effectiveness.

In identifying potential director candidates, the Nominating Committee seeks input from other members of the Board and executive officers and may also consider recommendations by employees, community leaders, business contacts, third-party search firms and any other sources deemed appropriate by the Nominating Committee. The Nominating Committee will also consider director candidates recommended by stockholders to stand for election at the Annual Meeting of Stockholders so long as such recommendations are submitted in accordance with the procedures described below under "Stockholder Recommendations of Director Candidates."

Stockholder Recommendations of Director Candidates. The Board does not have a formal policy regarding the consideration of director nominees recommended by stockholders, as historically it has not received such recommendations. However, the Board will consider such recommendations. Stockholders who wish to make such a recommendation should send the recommendation to Tree.com, Inc., 11115 Rushmore Drive, Charlotte, North Carolina 28277, Attention: Corporate Secretary. The envelope must contain a clear notation that the enclosed letter is a "Director Nominee Recommendation." The letter must identify the author as a stockholder, provide a brief summary of the candidate's qualifications and history, together with an indication that the recommended individual would be willing to serve (if elected), and must be accompanied by evidence of the sender's stock ownership. Any director recommendations will be reviewed by the Corporate Secretary and, if deemed appropriate, forwarded to the Chairman for further review. If the Chairman believes that the candidate fits the profile of a director described above, the recommendation will be shared with the entire Board.

The Board and Board Committees

The Board. The Board met seven times during 2010. During 2010, all the incumbent directors attended more than 75% of the meetings of the Board and the committees of the Board committees on which they served, except Mr. Horan who attended 70% of such meetings. Directors are not required to attend annual meetings of our stockholders.

Board Committees. The following table sets forth the current members of the Audit Committee, the Compensation Committee and the Nominating Committee:

Director Name	Audit Committee(1)	Compensation Committee	Nominating Committee(2)
W. Mac Lackey	X	X	
Joseph Levin	X		
Patrick McCrory	X	X	X
Lance Melber		X	X

(1) Mr. Horan served on the Audit Committee until July 2010, at which time he was replaced by Mr. Levin. Mr. Ozonian served on the Audit Committee until his resignation from the Board in November 2010, at which time he was replaced by Mr. McCrory.

(2) Mr. Ozonian served on the Nominating Committee until his resignation from the Board in November 2010.

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Audit Committee. The Audit Committee functions pursuant to a written charter adopted by the Board of Directors, a copy of which may be found at our website at *http://investor-relations.tree.com/governance.cfm*. The Audit Committee is appointed by the Board to assist the Board with a variety of matters described in its charter, which include monitoring (1) the integrity of our financial statements, (2) the effectiveness of our internal control over financial reporting, (3) the qualifications and independence of our independent registered public accounting firm, (4) the performance of our internal audit function and independent registered public accounting firm and (5) our compliance with legal and regulatory requirements. The Audit Committee met five times during 2010. The formal report of the Audit Committee is set forth on page 13.

Mr. Lackey and Mr. McCrory are independent directors within the meaning of the applicable NASDAQ listing standards. Mr. Levin is not an independent director. NASDAQ Rule 5605(c)(2)(B) permits the Company to appoint one non-independent director to the Audit Committee if the Board, under exceptional and limited circumstances, determines that membership on the Audit Committee by the non-independent director is in the best interests of the Company and its stockholders. The Board believes that Mr. Levin's expertise in financial reporting gained through his experience as Chief Executive Officer of Mindspark Interactive Network (a subsidiary of IAC) and previous other roles involving strategic planning, mergers and acquisitions and finance enable him to be a valuable asset to the Audit Committee. As a result, the Board has determined that Mr. Levin's service on the Audit Committee is in the best interests of the Company and our stockholders.

The Board has determined that Mr. Levin is an "audit committee financial expert," as such term is defined in applicable SEC rules.

Compensation Committee. The Compensation Committee functions pursuant to a written charter adopted by the Board of Directors, a copy of which may be found at our website at *http://investor-relations.tree.com/governance.cfm*. The Compensation Committee is responsible for discharging the Board's responsibilities relating to compensation of our Chief Executive Officer and our other executive officers and has overall responsibility for approving and evaluating all of our compensation plans, policies and programs as they affect our executive officers. For additional information on our processes and procedures for the consideration and determination of executive and director compensation and the roles of the Compensation Committee, see the discussion under the sections of this Proxy Statement captioned "Compensation Discussion and Analysis" and "Director Compensation" beginning on pages 18 and 43, respectively.

All of the members of the committee are independent directors within the meaning of the applicable NASDAQ listing standards. The Compensation Committee met five times during 2010. The formal report of the Compensation Committee is set forth on page 28.

Nominating Committee. The Nominating Committee functions pursuant to a written charter adopted by the Board, a copy of which may be found at our website at *http://investor-relations.tree.com/governance.cfm*. The Nominating Committee's functions include identifying, evaluating and recommending candidates for election to the Board. Additionally, the Nominating Committee is responsible for recommending compensation arrangements for non-employee directors. All of the members of the committee are independent directors within the meaning of the applicable NASDAQ listing standards. The Nominating Committee met four times during 2010.

Board Leadership Structure. Mr. Lebda serves as our CEO and Chairman of the Board of Directors. Mr. Lebda is the founder of the Company and has served as our CEO and Chairman of the Board since our August 2008 spin-off from IAC. The Board believes that it is important to have a unified leadership vision which Mr. Lebda is uniquely positioned to provide. The Board also believes that the Company is best served by a Chairman who is actively involved with the Company and is therefore able to bring a great depth of knowledge about the Company to the role. The Board does not currently have a designated lead independent director. The Board believes that the appointment of a designated lead independent director is not necessary at this time because of the Company's small size and because the independent directors play an active role in Board matters.

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Board Role in Risk Oversight. The Board oversees an enterprise-wide approach to risk management, designed to support the achievement of organizational objectives, including strategic objectives, to enhance long-term organizational performance and stockholder value. A fundamental part of risk management is not only understanding the risks we face, how those risks may evolve over time, and what steps management is taking to manage and mitigate those risks, but also understanding what level of risk tolerance is appropriate for us. Management is responsible for the day-to-day management of the risks we face, while the Board, as a whole and through its committees, has responsibility for the oversight of risk management. In its risk oversight role, the Board has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. The Board regularly reviews information regarding marketing, operations, finance and business development as well as the risks associated with each. In addition, the Board holds strategic planning sessions with management to discuss our strategies, key challenges, and risks and opportunities and receives a report on Sarbanes-Oxley compliance on at least an annual basis.

While the Board is ultimately responsible for risk oversight, committees of the Board also have been allocated responsibility for specific aspects of risk oversight. In particular, the Audit Committee assists the Board in fulfilling its oversight responsibilities with respect to risk management in the areas of financial reporting, internal controls, risk assessment and risk management. The Board and the Audit Committee regularly discuss with management the Company's major risk exposures, their potential financial impact on the Company, and the steps taken to monitor and control those risks. The Compensation Committee assists the Board in fulfilling its oversight responsibilities with respect to the risks arising from our compensation policies and programs. The Nominating Committee assists the Board in fulfilling its oversight responsibilities with respect to the risks associated with board organization, membership and structure, ethics and compliance, succession planning for our directors and executive officers, and corporate governance.

Stockholder Communications with the Board

Stockholders may, at any time, communicate with any of our directors by mailing a written communication to Tree.com, Inc., 11115 Rushmore Drive, Charlotte, North Carolina 28277, Attention: Corporate Secretary. The mailing envelope must contain a clear notation indicating that the enclosed letter is a "Stockholder-Board Communication" or "Stockholder-Director Communication." All such letters must identify the author as a stockholder, provide evidence of the sender's stock ownership and clearly state whether the intended recipients are all members of the Board or a particular director or directors. The Corporate Secretary will then review such correspondence and forward it to the Board, or to the specified director(s), if appropriate.

All communications received in accordance with these procedures will be reviewed by the Corporate Secretary and forwarded to the appropriate director or directors unless such communications are considered, in the reasonable judgment of the Corporate Secretary, to be improper for submission to the intended recipient. Examples of stockholder communications that would be considered improper for submission include communications that:

- do not relate to the business or affairs of our Company or the functioning or constitution of the Board or any of its committees;
- relate to routine or insignificant matters that do not warrant the attention of the Board;
- are advertisements or other commercial solicitations;
- are frivolous or offensive; or
- are otherwise not appropriate for delivery to directors.

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AUDIT COMMITTEE MATTERS

Audit Committee Report

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the need to implement or remediate controls, procedures and policies of acquired companies that lacked appropriate controls, procedures and policies prior to the acquisition;

- diversion of management time and focus from operating our business to acquisition integration challenges;
- cultural challenges associated with integrating employees from an acquired company into our organization;
- retaining employees from the businesses we acquire; and
- the need to integrate each company s accounting, management information, human resources and other administrative systems to permit effective management.

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

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

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

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

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

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

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

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

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

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

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

Fluctuations in operating results or the failure of operating results to meet the expectations of public market analysts and investors may negatively impact the value of our common stock. Quarterly operating results may fluctuate in the future due to a variety of factors that could affect revenue or expenses in any particular

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quarter. Fluctuations in quarterly operating results could cause the value of our securities to decline. Investors should not rely on quarter-to-quarter comparisons of results of operations as an indication of future performance. Factors that may affect our quarterly results include:

- the demand for, and acceptance of, our online personals services and enhancements to these services;
- the timing and amount of our subscription revenue;
- the introduction, development, timing, competitive pricing and market acceptance of our Web sites and services and those of our competitors;
- the magnitude and timing of marketing initiatives and capital expenditures relating to expansion of our operations;
- the cost and timing of online and offline advertising and other marketing efforts;
- the maintenance and development of relationships with portals, search engines, ISPs and other Web properties and other entities capable of attracting potential members and paying subscribers to our Web sites;
- technical difficulties, system failures, system security breaches, or downtime of the Internet, in general, or of our products and services, in particular;
- costs related to any acquisitions or dispositions of technologies or businesses;
- fluctuations in foreign exchange rates; and
- general economic conditions, as well as those specific to the Internet, online personals and related industries.

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

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

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

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

One of our strategies is to expand our presence in international markets. Although we currently have offices in Israel and Web sites that directly serve the 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

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carries additional risk for our business as a result of continuing hostilities there. Expansion into international markets requires management time and capital resources. In addition, we face the following additional risks associated with our expansion outside the United States:

- challenges caused by distance, language and cultural differences;
- local competitors with substantially greater brand recognition, more users and more traffic than we have;
- our need to create and increase our brand recognition and improve our marketing efforts internationally and build strong relationships with local affiliates;
- longer payment cycles in some countries;
- credit risk and higher levels of payment fraud in some countries;
- different legal and regulatory restrictions among jurisdictions;
- 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. Currency risk positions could change correspondingly and the use of foreign exchange hedging instruments could become necessary. Effects of exchange rate fluctuations on our financial condition, operations and profitability may depend on our ability to manage our foreign currency risks. There can be no assurance that steps taken by management to address foreign currency fluctuations will eliminate all adverse effects and, accordingly, we may suffer losses due to adverse foreign currency fluctuation.

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

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

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

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

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

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

Risks Related to Our Industry

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

The majority of our revenue is generated by internet users that pay us a subscription fee. One of our key performance metrics focuses on the average number of paying subscribers in a given period. The number of monthly average paying subscribers is calculated as the sum of the paying subscribers at the beginning and end of the month, divided by two. Average paying subscribers for periods longer than one month are calculated as the sum of the average paying subscribers for each month, divided by the number of months in the period. Internet users, in general, and users of online personals services specifically, freely navigate and use the services offered by a variety of Web sites. We cannot assure you that our monthly average paying subscriber numbers will remain at consistent levels, and they may decrease in the future, thus decreasing our revenue. In 2011, average paying subscribers increased 21.3% and revenue also increased 18.7% compared to 2010. If we do not constantly attract new paying subscribers at a faster rate than subscription terminations, our average paying subscribers will decrease and we will not be able to maintain or increase our current level of revenue.

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

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

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

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

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

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

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

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

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

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

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

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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.

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

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

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

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

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

Risks Related to Owning Our Securities

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

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

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

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

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

As of March 27, 2012, Great Hill Investors, LLC, North Run Advisors, LLC, and Osmium Partners, LLC and their respective affiliates beneficially owned approximately, in the aggregate, 66% of our outstanding common stock. Great Hill Investors, LLC and its affiliates (Great Hill) became our largest stockholder on December 1, 2005 when it purchased an aggregate of 6,000,000 ordinary shares in four privately negotiated transactions and it subsequently acquired an additional 3,085,000 shares. Great Hill and its affiliates held an aggregate of 9,085,000 shares of common stock as of March 27, 2012. These stockholders possess significant influence over our company. Such ownership and control may have the effect of delaying or preventing a change in control of our company, impeding a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company. Furthermore, such ownership may have the effect of control over substantially all matters requiring stockholder approval, including the election of directors. Other than the arrangement to elect a director at the selection of Great Hill which affects some of these stockholders, as discussed below, we do not expect that these stockholders will vote together as a group. It should be noted that Great Hill Investors, LLC ownership information is based on a Schedule 13D/A filed with the SEC on March 2, 2010, North Run Advisors, LLC ownership information is based on a Schedule 13F filed with the SEC on February 10, 2012 and Osmium Partners, LLC ownership information is based on a Schedule 13D filed with the SEC on February 14, 2012.

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

As of March 27, 2012, Great Hill beneficially owned 9,085,000 shares of our common stock, or approximately 44.1% of our outstanding common stock, and has voting control of an aggregate of approximately 48.7% of our securities to elect a director of our company subject to the terms and conditions of the share purchase agreements entered into on December 1, 2005 with certain selling stockholders (collectively, the Selling Stockholders). Pursuant to the terms of the share purchase agreements with each of the Selling Stockholders, for so long as Great Hill collectively owns at least 10% or 5%, depending on the Selling Stockholder, each Selling Stockholder agreed that:

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

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

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

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

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

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

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.

There are no cumulative voting rights provided for in our bylaws or certificate of incorporation. Our certificate of incorporation and bylaws also contain provisions that could have the effect of discouraging potential acquisition proposals or making a tender offer or delaying or preventing a change in control, including changes a stockholder might consider favorable. In particular, the certificate of incorporation and bylaws, as applicable, among other things:

- provide the board of directors with the ability to alter the bylaws without stockholder approval;
- provide for an advance notice procedure with regard to the nomination of candidates for election as directors and with regard to business to be brought before a meeting of stockholders; and
- provide that vacancies on the board of directors may be filled by a majority of directors in office, although less than a quorum.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

We do not own any real property that is materially important to our business. Our headquarters is located in Beverly Hills, California, where we occupy approximately 16,000 square feet of office space, housing our technology department and most of our corporate and administrative personnel. Our current lease for this space runs from August 1, 2011 through July 31, 2013 with monthly base rent starting at $42,193 for the first year with 4 months of 50% abated rate during the first year of the term, and increasing to $43,459 for the second year with 8 months of 50% abated rate during the second year of the term. We also leased office space in Utah and Israel and datacenter space in California and Utah in 2011. 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

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

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for the Fifth Circuit, which was granted. Oral argument was held on December 8, 2011. Per the Fifth Circuit s request, the parties submitted supplemental briefs on December 16, 2011. On March 21, 2012, the Fifth Circuit issued its opinion affirming the District Court s dismissal of certain claims and reversing the dismissal of certain other claims.

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

On March 11, 2010, L.I.S.T. Incorporated initiated a class action lawsuit against Spark Networks, Inc., Adam S. Berger, Jonathan B. Bulkeley, Benjamin Derhy, Thomas G. Stockham, Michael A. Kumin, Great Hill Equity Partners III, LP and Great Hill Partners, LLC in the Court of Chancery of the State of Delaware, alleging breach of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own. On September 10, 2010, the Company announced that the Board of Directors had disbanded the Special Committee of independent directors which had been formed to consider the proposal made by Great Hill to purchase all of the outstanding shares of common stock of the Company not owned by Great Hill and other strategic alternatives available to the Company. The action initiated by L.I.S.T. was dismissed by plaintiff without prejudice on March 4, 2011.

Ness Interactive v. Spark Networks Limited

On January 22, 2010, Spark Networks Limited was served with a complaint from Ness Interactive alleging that Spark Networks engaged in unfair competition by bidding on certain online advertising keywords in France. Spark Networks Limited filed its initial response on October 15, 2010 and counterclaimed that Ness engaged in unfair competition. The parties settled the case and it was dismissed by the court on May 6, 2011.

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.

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. MINE SAFETY DISCLOSURES

Not Applicable.

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PART II.

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

Market Information

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

	High	Low
Year ended December 31, 2010		
First Quarter	$ 3.60	$ 2.67
Second Quarter	$ 3.87	$ 3.26
Third Quarter	$ 3.41	$ 2.92
Fourth Quarter	$ 3.22	$ 2.90

	High	Low
Year ended December 31, 2011		
First Quarter	$ 3.33	$ 3.01
Second Quarter	$ 3.33	$ 3.11
Third Quarter	$ 3.74	$ 3.00
Fourth Quarter	$ 3.83	$ 3.00

Holders

As of March 27, 2012, there were 60 holders of record of our common stock.

Dividends

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

Securities Authorized for Issuance Under Equity Compensation Plans

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

Unregistered Sales of Equity Securities

During the year ended December 31, 2011, we did not issue unregistered securities.

Purchases of Equity Securities

We did not purchase any shares in the year ended December 31, 2011.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable for a smaller reporting company

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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 expressions. forward-looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Our actual results could differ materially from those anticipated in these forward-looking statements, which are subject to a number of risks, uncertainties and assumptions described in the Risk Factors section and elsewhere in this report.

General

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

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

For the year ended December 31, 2011, we had 196,850 average paying subscribers, representing an increase of 21.3% from the year ended December 31, 2010. 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, ChristianMingle.com, which primarily targets Christian singles in the United States, Spark.com, which targets singles in the United States, and BlackSingles.com, which primarily targets African-American singles in the United States. Our subscription fees have traditionally been charged on a monthly basis, with discounts for longer-term subscriptions.

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

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

Critical Accounting Policies, Estimates and Assumptions

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

Management has discussed the development and selection of our critical accounting policies, estimates and assumptions with our board of directors and the board has reviewed these disclosures. Past estimates have been in line with actual results.

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

Revenue Recognition and Deferred Revenue

Substantially all of our revenue is derived from subscription fees. Revenue is presented net of credits and credit card chargebacks. We recognize revenue in accordance with accounting principles generally accepted in the United States. Revenue recognition occurs ratably over the subscription period, beginning when there is persuasive evidence of an arrangement, delivery has occurred (access has been granted), the fees are fixed or determinable, and collection is reasonably assured. Paying subscribers primarily pay in advance using a credit card and, subject to certain conditions identified in our terms and conditions, all purchases are final and nonrefundable. Subscription fees collected in advance are deferred and recognized as revenue, using the straight-line method, over the term of the subscription. We reserve for potential credit card chargebacks based on our historical chargeback experience.

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

Cost of Revenue

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. We incur substantial expenses related to our advertising in order to generate traffic to our Web sites. These advertising costs consist of television and online advertising, including affiliate and co-brand arrangements, and are directly attributable to the revenue we receive from our subscribers. We have

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entered into numerous affiliate arrangements, under which our affiliates advertise or promote our Web site, and earn a fee whenever visitors click through the affiliate s advertisement to one of our Web sites and register or subscribe, on our Web site. We do not typically have any exclusivity arrangements with our affiliates, and some of our affiliates may also be affiliates for our competitors. Under our co-branded arrangements, our co-brand partners may operate their own separate Web sites where visitors can register and subscribe to our Web sites. Affiliate deals, co-brand deals and online advertising arrangements may fall in the categories of CPS, CPA, CPC, or CPM, as discussed below.

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

- Cost per subscription (CPS) where we pay an online advertising provider a fee based upon the number of new paying subscribers it generates;

- Cost per acquisition (CPA) where we pay an online advertising provider a fee based on the number of new member registrations it generates;

- Cost per click (CPC) where we pay an online advertising provider a fee based on the number of clicks to our Web sites it generates; and

- Cost per thousand for banner advertising (CPM) where we pay an online advertising provider a fee based on the number of times it displays our advertisements.

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

Prepaid Advertising Expenses

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

Web Site and Software Development Costs

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

We expense costs related to the planning and post implementation phases of Web site development efforts. Direct costs incurred in the development phase are capitalized. Costs associated with minor enhancements and maintenance for a Web site are included in expenses in the accompanying consolidated statements of operations.

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

We test goodwill and indefinite-lived intangible assets for impairment at least annually, or more frequently when circumstances indicate that the carrying value may not be recoverable and test property, plant and equipment and other intangible assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Factors we consider important and which could trigger an impairment review include the following:

a significant decline in actual projected revenue;

a significant decline in the market value of our common stock;

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

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

In 2011 and 2010, the Company performed its annual impairment analysis and determined the fair value of each reporting unit and compared it to the carrying amount of the reporting unit. We estimate the fair value of the reporting unit based on the market approach and income approach. The income approach relies upon discounted future cash flows which are derived from various assumptions including: projected cash flows, discount rates, projected long-term growth rates and terminal values. We used a discount rate which we believe reflects the risks and uncertainty related to each reporting unit. The analysis concluded that the estimated fair value of the Jewish Networks business was higher than its carrying value and the estimated fair value of the Other Affinity Networks business was higher than its carrying value. At the conclusion of the analysis, it was determined that impairment was not warranted.

As of December 31, 2011, Jewish Networks and Other Affinity Networks carried goodwill balances of $6.8 million and $1.9 million, respectively.

In 2009, we performed our annual impairment analysis and determined the fair value of each reporting unit and compared it to the carrying amount of the reporting unit. The fair value of the Jewish Networks reporting unit was higher than the carrying value as of December 31, 2009 and thus did not require any impairment. Based upon several valuation assumptions, including lower expected performance and lower industry multiples, the analysis concluded that the book carrying value of the Other Affinity Networks business was higher than its estimated fair value. As a result, the Company performed the second step under the guidance to assess the fair value of the assets and liabilities of Other Affinity Networks. The analysis resulted in impairment to goodwill and domain names of $9.3 million and $1.3 million, respectively. In 2009, we paid the final $1.4 million in earn-out payments for the acquisition of the HurryDate business in 2007. The earn-out payments were recorded as impairment expense based on business performance. There were no additional impairments as a result of the assessment.

In 2011 and 2010, we impaired approximately $45,000 and $121,000, respectively, of capitalized software development costs when we determined that a web-based product failed to perform to Company standards.

In 2011 and 2010, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value based upon the expected future cash flows generated from the businesses associated with these assets, resulting in impairment charges of approximately $1.1 million and $187,000 respectively.

Accounting for Business Combinations

We acquired the stock or specific assets of a number of companies from 1999 through 2008 some of which were considered to be business acquisitions. Under the purchase method of accounting, the 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.

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

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

The value of our intangible and other long-lived assets, including goodwill, is exposed to future adverse changes if we experience declines in operating results or experience significant negative industry or economic trends or if future performance is below historical trends.

Legal Contingencies

We are currently involved in certain legal proceedings, as discussed in the notes to the financial statements and under 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.

At December 31, 2011, we had gross net operating loss (NOL) carry-forwards for income tax purposes of approximately $8.5 million and $36.4 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2025 for federal purposes and 2018 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.

As a result of the adoption of the share-based payment guidance, the Company will recognize excess tax benefits associated with the exercise of stock options directly to stockholders equity only when realized. Accordingly, deferred tax assets are not recognized for NOL carry forwards resulting from excess tax benefits. As of December 31, 2011, deferred tax assets do not include approximately $4.8 million of these excess tax benefits from employee stock option exercises that are a component of the Company s NOL carry forwards. Additional paid in capital will be increased up to an additional $4.8 million if and when such excess tax benefits are realized. During 2011, approximately $67,000 of net excess tax benefits were realized.

We operate in multiple taxing jurisdictions, both within the United States and outside the United States. We have filed tax returns with positions that may be challenged by the tax authorities. These positions relate to, among others, transfer pricing, the deductibility of certain expenses, intercompany transactions as well as other matters.

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Although the outcome of tax audits is uncertain, we regularly assesses our tax position for such matters and, in management s opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. To the extent reserves are recorded, they will be utilized or reversed once the statute of limitations has expired and/or at the conclusion of the tax examination. We believe that the ultimate outcome of these matters will not have a material impact on our financial position or liquidity. We recognize the tax effects from an uncertain tax position in our financial statements, only if the position is more-likely-than-not of being sustained on audit, based on the technical merits of the position. Tax positions that meet the recognition threshold are reported at the largest amount that is more-likely-than-not to be realized.

Stock Based Compensation

We adopted the Share-Based Payment guidance in 2005 using the modified prospective approach. Prior to our adoption of the guidance, we did not record tax benefits of deductions resulting from the exercise of stock options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2011 and 2010, we recognized cash inflows of approximately $89,000 and $1.7 million, respectively, related to tax provision or benefit from stock-based compensation.

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

Our computation of expected volatility is based on a combination of historical and market-based implied volatility. The volatility rate was derived by examining historical stock price behavior and assessing management s expectations of stock price behavior during the term of the option. The term of the options was derived based on the simplified method calculation. We are using the simplified method calculation, which is derived by averaging the vesting term with the contractual terms.

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.

Segment Reporting

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for making operating decisions and assessing performance. The Company s financial reporting includes detailed data on four separate operating segments which were principally determined based on similarity of economic characteristics. For the periods covered by the financial statements in this report, our financial reporting data consists of four reportable 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) 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; (3) 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 (4) Offline and Other Businesses, which consists of

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revenue generated from offline activities, HurryDate events and subscriptions, and other Web sites and businesses.

Results of Operations

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

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

	2011	2010	2009
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenue	59.7	33.7	33.5
Sales and marketing	7.7	8.6	7.7
Customer service	4.1	3.9	4.0
Technical operations	2.8	3.0	3.3
Development	5.6	7.6	8.6
General and administrative	16.6	23.7	21.9
Depreciation	2.7	2.4	1.9
Amortization of intangible assets other than goodwill	0.8	1.0	1.5
Impairment of goodwill, long-lived assets and other assets	2.4	0.8	26.4
Total costs and expenses	102.4	84.7	108.8
Operating (loss) income	(2.4)	15.3	(8.8)
Interest and other (income) expenses, net	0.3	(0.1)	(2.4)
(Loss) income before income taxes	(2.7)	15.4	(6.4)
Provision for income taxes	0.6	6.3	7.7
Net (loss) income	(3.3)%	9.1%	(14.1)%

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

(in thousands)	**2011**	**2010**	**2009**
Net (loss) income	$ (1,611)	$ 3,704	$ (6,404)
Interest expense	102	207	378
Income taxes	305	2,558	3,479
Depreciation	1,320	962	873
Impairments	1,145	308	11,999
Amortization of intangible assets	370	421	663
Non-cash currency translation adjustments	337	(269)	(30)
Stock-based compensation	906	1,510	1,041
Non-repetitive property possession	(247)		(1,507)
Adjusted EBITDA[(1)]	**$ 2,627**	**$ 9,401**	**$ 10,492**

(1) The Company reports Adjusted EBITDA as a supplemental measure to generally accepted accounting principles (GAAP). This measure is one of the primary metrics by which we evaluate the performance of our businesses, budget, forecast and compensate management. We

believe this measure provides management and investors with a consistent view, period to period, of the core earnings generated from on-going operations and excludes the impact of: (i) non-cash items such as stock-based compensation, asset impairments, non-cash currency translation adjustments related to an inter-company loan and (ii) one-time items that have not occurred in the past two years and are not expected to recur in the next two years. Adjusted EBITDA has inherent limitations in evaluating the performance of the Company, including, but not limited to the following:

- Adjusted EBITDA does not reflect the cash capital expenditures during the measurement period,
- Adjusted EBITDA does not reflect any changes in working capital requirements during the measurement period,
- Adjusted EBITDA does not reflect the cash tax payments during the measurement period, and
- Adjusted EBITDA may be calculated differently by other companies in our industry, thus limiting its value as a comparative measure.

Adjusted EBITDA should not be construed as a substitute for net income (loss) (as determined in accordance with GAAP) for the purpose of analyzing our operating performance or financial position, as Adjusted EBITDA is not defined by GAAP.

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:

	Year Ended December 31,		
	2011	**2010**	**2009**
Average Paying Subscribers			
Jewish Networks	89,429	90,452	86,030
Other Affinity Networks	103,768	64,851	66,078
General Market Networks	3,138	6,328	13,219
Offline and Other Businesses	515	680	940
Total Average Paying Subscribers	**196,850**	**162,311**	**166,267**

Average paying subscribers for the Jewish Networks segment decreased 1.1% to 89,429 for the year ended December 31, 2011 compared to 90,452 in 2010. Average paying subscribers for the Other Affinity Networks segment increased 60.0% to 103,768 for the year ended December 31, 2011 compared to 64,851 in 2010, reflecting increased direct marketing investment within this segment. Average paying subscribers for the General Market Networks segment decreased 50.4% to 3,138 for the year ended December 31, 2011 compared to 6,328 in 2010. This decrease can be primarily attributed to a reduction in inefficient marketing spend in prior and current periods. Average paying subscribers for the Offline and Other Businesses segment decreased 24.3% to 515 for the year ended December 31, 2011 compared to 680 in 2010, primarily due to the operating results of HurryDate.

Average paying subscribers for the Jewish Networks segment increased 5.1% to 90,452 for the year ended December 31, 2010 compared to 86,030 in 2009. We believe the increase in average paying subscribers is due in part to a shift in our pricing strategy and new product offerings. Average paying subscribers for the Other Affinity Networks segment decreased 1.9% to 64,851 for the year ended December 31, 2010 compared to 66,078 in 2009, reflecting a shift in brand investment within this segment. Average paying subscribers for the General

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Market Networks segment decreased 52.1% to 6,328 for the year ended December 31, 2010 compared to 13,219 in 2009. This decrease can be primarily attributed to a reduction in inefficient marketing spend. Average paying subscribers for the Offline and Other Businesses segment decreased 27.7% to 680 for the year ended December 31, 2010 compared to 940 in 2009, primarily due to the operating results of HurryDate.

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

Segment Reclassification

During the first quarter of 2012, the Company changed management s internal reporting to include data on four newly-defined operating segments: (1) Jewish Networks, which consists of JDate.com, JDate.co.il, Cupid.co.il, and their respective co-branded Web sites; (2) Christian Networks, which consists of ChristianMingle.com, ChristianMingle.co.uk, ChristianMingle.com.au and Believe.com; (3) Other Networks, which consists of Spark.com and properties which are primarily made up of sites targeted towards various religious, ethnic, geographic and special interest groups; and (4) Offline & Other Businesses, which consists of revenue generated from offline activities and HurryDate events and subscriptions. The Company believes the new segments will provide investors with greater transparency into the performance of the business.

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Revenue

Substantially all of our revenue is derived from subscription fees. Approximately 5.0% and 5.2% of our revenue for the years ended December 31, 2011 and 2010, respectively, were 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 until subscribers terminate them.

Revenue for the year ended December 31, 2011 increased 18.7% to $48.5 million from $40.9 million in 2010. The revenue increase can be primarily attributed to a 78.1% increase in Other Affinity Networks revenue.

Revenue for the Jewish Networks segment decreased 1.4% to $27.1 million for the year ended December 31, 2011, compared to $27.4 million in 2010. The lower Jewish Networks revenue reflects a 0.5% decrease in average revenue per user (ARPU), and a 1.1% decrease in average paying subscribers. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related price. Revenue for our Other Affinity Networks segment increased 78.1% to $20.1 million for the year ended December 31, 2011, compared to $11.3 million in 2010. The higher Other Affinity Networks revenue reflects an 11.3% increase in ARPU, and a 60.0% increase in average paying subscribers. The higher 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 50.5% to $578,000 for the year ended December 31, 2011, compared to $1.2 million in 2010. The decrease in General Market Networks revenue is due to a 50.4% decrease in average paying subscribers, reflecting the elimination of inefficient online marketing expenses in prior and current periods. Revenue of our Offline and Other Businesses segment decreased 19.9% to $772,000 for the year ended December 31, 2011 compared to $1.0 million in 2010. The decrease in revenue is attributable to fewer hosted events in 2011.

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Costs and Expenses

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses increased 43.3% to $49.6 million for the year ended December 31, 2011, compared to $34.6 million in 2010. The increase is primarily attributable to a $15.2 million increase in cost of revenue.

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 increased 110.6% to $29.0 million for the year ended December 31, 2011, compared to $13.7 million in 2010. This increase can be primarily attributed to higher Other Affinity Networks direct marketing expenses. Direct marketing expenses for the Other Affinity Networks segment increased 194.3% to $21.5 million for the year ended December 31, 2011, compared to $7.3 million in 2010. The higher marketing expense reflects management s focus on increasing market share and cultivating greater brand awareness for a handful of Web sites in this segment.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses increased 6.5% to $3.7 million for the year ended December 31, 2011, compared to $3.5 million in 2010. The increase can be primarily attributed to growth in compensation expense and consulting fees. The Company increased its marketing team headcount in 2011, which led to higher compensation expense.

Customer Service. Customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members. Customer service expenses increased 23.7% to $2.0 million for the year ended December 31, 2011, compared to $1.6 million in 2010. The expense increase is primarily attributed to higher compensation costs, reflecting increased support for our growing Other Affinity Networks segment.

Technical Operations. Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses increased 11.0% to $1.4 million for the year ended December 31, 2011, compared to $1.2 million in 2010. The increase reflects higher compensation expense associated with additional personnel.

Development. Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses decreased by 12.4% to $2.7 million for the year ended December 31, 2011, compared to $3.1 million in 2010. The decreased costs reflect lower salary expense due to personnel changes and higher capitalized salaries associated with software development.

General and Administrative. General and administrative expenses consist primarily of corporate personnel-related costs, professional fees, occupancy and other overhead costs. General and administrative expenses decreased 17.5% to $8.1 million for the year ended December 31, 2011, compared to $9.8 million in 2010. In 2010, the Company incurred approximately $1.0 million in non-recurring charges associated with our Special Committee process, litigation related to the Special Committee process and the transfer of certain assets out of our United Kingdom entity into two United States entities.

Depreciation. Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expense increased by 37.2% to $1.3 million for the year ended December 31, 2011, compared to $962,000 in 2010. Higher capitalized software which started in 2010 accounted for the increase in depreciation expenses.

Amortization of Intangible Assets. Amortization expenses consist primarily of amortization of intangible assets related to acquisitions, primarily LDSSingles and HurryDate. Amortization expense decreased 12.1% to

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$370,000 for the year ended December 31, 2011, compared to $421,000 in 2010. The decrease reflects the full amortization of MingleMatch and LDSSingles assets.

Impairment of Long-lived Assets. Impairment of long-lived assets primarily represents the write-down of investments in businesses and computer software. Long-lived assets impairment expense was $1.1 million for the year ended December 31, 2011, compared to $308,000 in 2010. In 2011, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value.

Interest Expense (income) and Other, Net. Interest expense (income) and other consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Interest expense (income) and other reflected a $162,000 expense for the year ended December 31, 2011, compared to income of $54,000 in 2010. The change is primarily due to non-cash foreign exchange rate fluctuations related to the intercompany loan with our Israel subsidiary, offset by a $247,000 gain recorded for assets received from a legal judgment.

Net (loss) Income and Net (loss) Income Per Share. Net loss was $1.6 million, or $0.08 per share, for the year ended December 31, 2011, compared to net income of $3.7 million or $0.18 per share in 2010. The net loss in 2011 was primarily due to increases in direct marketing investments.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

Revenue

Substantially all of our revenue is derived from subscription fees. Approximately 5.2% and 4.9% of our revenue for the years ended December 31, 2010 and 2009, respectively, is 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 until subscribers terminate them.

Revenue for the year ended December 31, 2010 decreased 10.0% to $40.9 million from $45.4 million in 2009. The revenue decrease can be primarily attributed to a 4.9% decrease in Jewish Networks revenue, a 56.6% decrease in General Market Networks revenue and an 11.7% decrease in Other Affinity Networks revenue.

Revenue for the Jewish Networks segment decreased 4.9% to $27.4 million for the year ended December 31, 2010, compared to $28.8 million in 2009. The lower Jewish Networks revenue reflects a 9.0% decrease in average revenue per user (ARPU), offset by a 5.1% increase in average paying subscribers. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related price points as we focused on growing our network. Revenue for the General Market Networks segment decreased 56.6% to $1.2 million for the year ended December 31, 2010, compared to $2.7 million in 2009. The decrease in General Market Networks revenue is due to a 52.1% decrease in average paying subscribers, reflecting the elimination of inefficient online marketing expenses. Revenue for our Other Affinity Networks segment decreased 11.7% to $11.3 million for the year ended December 31, 2010, compared to $12.8 million in 2009. The lower Other Affinity Networks revenue reflects an 11.9% decrease in ARPU, and a 1.9% decrease in average paying subscribers. The lower ARPU reflects a shift in the mix of plans purchased by our subscribers and their related price points as we shifted our focus to a select group of brands within this segment. Revenue of our Offline and Other Businesses segment decreased 11.0% to $1.0 million for the year ended December 31, 2010 compared to $1.1 million in 2009. The decrease in revenue is attributable to fewer hosted events in 2010.

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Costs and Expenses

Costs and expenses consist primarily of cost of revenue, sales and marketing, customer service, technical operations, development and general and administrative expenses. Costs and expenses decreased 29.9% to $34.6 million for the year ended December 31, 2010, compared to $49.4 million in 2009. Excluding asset impairment charges, operating expenses decreased 8.2% to $34.3 million in 2010 compared to $37.4 million in 2009. Lower cost of revenue and development expense accounted for the majority of the decrease.

Cost of Revenue. Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Cost of revenue decreased 9.6% to $13.7 million for the year ended December 31, 2010, compared to $15.2 million in 2009. The decrease can be primarily attributed to an 11.1% decline in direct marketing expenses. The Other Affinity Networks segment accounted for the majority of the reduction in direct marketing expenses, where costs decreased 14.2% to $7.3 million for the year ended December 31, 2010, compared to $8.5 million in 2009. The lower marketing expense reflects management s focus on increasing market share and cultivating greater brand awareness for a handful of Web sites in this segment.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries for our sales and marketing personnel. Sales and marketing expenses remained flat at $3.5 million for the years ended December 31, 2010 and 2009.

Customer Service. Customer service expenses consist primarily of personnel costs associated with our customer service centers. The members of our customer service team primarily respond to billing questions, detect fraudulent activity and eliminate suspected fraudulent activity, as well as address site usage and dating questions from our members. Customer service expenses decreased 12.6% to $1.6 million for the year ended December 31, 2010, compared to $1.8 million in 2009. The decrease in total dollars is primarily due to lower wages, reflecting the full year impact of migrating our customer service group from Beverly Hills, CA to Provo, UT.

Technical Operations. Technical operations expenses consist primarily of the personnel and systems necessary to support our corporate technology requirements. Technical operations expenses decreased 18.1% to $1.2 million for the year ended December 31, 2010, compared to $1.5 million in 2009. The decrease in total dollars is due primarily to an increase in capitalized software, lower recruiter placement fees and a reduction in technology support and maintenance expense.

Development. Development expenses consist primarily of costs incurred in the development, enhancement and maintenance of our Web sites and services. Development expenses decreased by 20.6% to $3.1 million for the year ended December 31, 2010, compared to $3.9 million in 2009. The decrease in total dollars is primarily due to lower wages and consulting fees. The lower wages reflect a reduction in headcount, while the lower consulting fees reflect the completion of the launch of Kizmeet.com, the completion of certain new product features and the absorption of other projects by our existing workforce in the fourth quarter of 2009.

General and Administrative. General and administrative expenses consist primarily of corporate personnel-related costs, professional fees, occupancy and other overhead costs. General and administrative expenses decreased 1.5% to $9.8 million for the year ended December 31, 2010, compared to $9.9 million in 2009. In 2010, the Company incurred approximately $1.0 million in non-recurring charges associated with our Special Committee process, litigation related to the Special Committee process and the transfer of certain assets out of our United Kingdom entity into two United States entities.

Depreciation. Depreciation expenses consist primarily of depreciation of capitalized software costs, computer hardware and other fixed assets. Depreciation expense increased by 10.2% to $962,000 for the year ended December 31, 2010, compared to $873,000 in 2009.

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Amortization of Intangible Assets. Amortization expenses consist primarily of amortization of intangible assets related to acquisitions, primarily MingleMatch, LDSSingles and HurryDate. Amortization expense decreased 36.5% to $421,000 for the year ended December 31, 2010, compared to $663,000 in 2009. The decrease is mainly due to fully amortized costs associated with HurryDate members in early 2010.

Interest Expense (Income) and Other, Net. Interest expense (income) and other consist primarily of interest income associated with short-term investments and cash deposits in interest bearing accounts, income or expense related to currency fluctuations and interest expense associated with borrowings from our revolving credit facility. Net interest and other income was $54,000 for the year ended December 31, 2010, compared to $1.1 million in 2009. The income in 2009 primarily reflects a $1.5 million gain associated with the possession of certain assets pursuant to a judgment awarded in favor of the Company.

Net Income (Loss) and Net Income (Loss) Per Share. Net income was $3.7 million, or $0.18 per share, for the year ended December 31, 2010, compared to a net loss of $6.4 million or $0.31 per share in 2009. The lower net income in 2009 was primarily due to an impairment expense related to goodwill and other long-lived assets of $12 million in 2009.

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Quarterly Results of Operations

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

	Three Months Ended (1)							
(in thousands)	**Dec. 31, 2011**	**Sept. 30, 2011**	**June 30, 2011**	**March 31, 2011**	**Dec. 31, 2010**	**Sept. 30, 2010**	**June 30, 2010**	**March 31, 2010**
Consolidated Statement of Operations Data:								
Revenue	$ 12,861	$ 12,677	$ 11,995	$ 10,960	$ 10,109	$ 9,916	$ 10,289	$ 10,537
Cost of revenue	8,420	7,373	7,347	5,815	4,002	3,206	3,384	3,157
Sales and marketing	1,062	923	837	900	788	774	851	1,083
Customer service	539	531	449	461	420	403	382	396
Technical operations	281	336	336	414	302	252	315	363
Development	643	643	679	745	760	773	778	781
General and administrative	1,071	2,435	2,199	2,363	2,141	2,316	2,538	2,787
Depreciation	343	341	346	290	263	242	222	235
Amortization	89	90	93	98	97	98	104	122
Impairment of goodwill and other assets	1,100	45			187			121
Total operating expenses	13,548	12,717	12,286	11,086	8,960	8,064	8,574	9,045
Income (loss) from operations	(687)	(40)	(291)	(126)	1,149	1,852	1,715	1,492
Interest expense (income) and other, net	144	120	(45)	(57)	(72)	(182)	241	(41)
Income (loss) before income taxes	(831)	(160)	(246)	(69)	1,221	2,034	1,474	1,533
Provision for income taxes	277	78	(165)	115	595	808	551	604
Net (loss) income	$ (1,108)	$ (238)	$ (81)	$ (184)	$ 626	$ 1,226	$ 923	$ 929
Basic and diluted net (loss) income per share	$ (0.05)	$ (0.01)	$ (0.00)	$ (0.01)	$ 0.03	$ 0.06	$ 0.04	$ 0.05
Shares used in computation of basic net income per share[1]	20,595	20,595	20,589	20,587	20,587	20,587	20,587	20,582
Shares used in computation of diluted net income per share	20,595	20,595	20,589	20,587	20,588	20,590	20,598	20,582
Average paying subscribers[2]	212,850	206,099	190,160	178,292	160,744	158,422	160,239	169,833
Costs and expenses include stock-based compensation as follows:								
Cost of revenue	$ 2	$ 2	$ 2	$ 2	$ 3	$ 3	$ 3	$ 2
Sales and marketing	15	17	14	34	35	39	42	117
Customer service								1
Technical operations	31	30	27	31	33	30	31	73
Development	10	10	10	12	12	14	15	13
General and administrative	125	124	226	182	187	172	181	504

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

(2) Represents average paying subscribers calculated as the sum of the average paying subscribers for each month in the period, divided by the three. 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.

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Liquidity and Capital Resources

As of December 31, 2011, we had cash and cash equivalents of $15.1 million. We have historically financed our operations with internally generated funds.

Net cash provided by operations was $3.1 million for the year ended December 31, 2011 compared to $5.8 million for the same period in 2010.

Net cash used by investing activities was $1.9 million for 2011 compared to net cash provided by investing activities of $199,000 for 2010. In 2010, the Company received $1.6 million in connection with the sale of certain real property received in 2009 as a result of a judgment in favor of the Company. Capital expenditures for 2011 and 2010 were $1.6 million and $1.3 million, respectively, representing the purchase of computer hardware and capitalized software.

Net cash provided by financing activities was $88,000 for the year ended December 31, 2011 compared to $1.7 million for 2010. Cash provided by financing activities in 2010 was primarily related to the recognition of an excess tax benefit from stock-based compensation of $1.7 million compared to $67,000 in 2011.

The Company and its wholly-owned subsidiary, Spark Networks USA, LLC have 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 December 31, 2011.

As of December 31, 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 year ended December 31, 2011 and December 31, 2010 were $56,000 and $141,000, respectively.

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

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Contractual Obligations

The following table describes our contractual commitments and obligations as of December 31, 2011 (in thousands):

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
Operating leases	$ 623	$ 760	$ 320	$	$ 1,703
Other commitments and obligations	321	321			642
Total contractual obligations	$ 944	$ 1,081	$ 320	$	$ 2,345

We had commitments and obligations consisting of operating leases, contracts with software licensing, communications, computer hosting and marketing service providers. Other commitments and obligations totaled $321,000 for less than one year. Contracts with other service providers are for 30 day terms or less. For contingences related to our tax positions, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months. As a result, this amount is not included in the table above.

Off-Balance Sheet Arrangements

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

Recent Accounting Developments

In May 2011, the FASB issued a new accounting standard update, which amends the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for fiscal years beginning after December 15, 2011. We adopted this standard in the first quarter of 2012 and the adoption will not have a material impact on our financial statements and disclosures.

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. In addition, in December 2011, the FASB issued an amendment to an existing accounting standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The new guidance will be effective for the Company beginning January 1, 2012 and will only impact the presentation of financial statements.

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We adopted this standard in the first quarter of 2012 and the adoption will not have a material impact on our financial statements.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable for a smaller reporting company.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer performed an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2011.

Internal Control Over Financial Reporting

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

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of the Company s management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on criteria established in the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, the Company s management concluded that its internal control over financial reporting was effective as of December 31, 2011.

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

(b) Attestation Report

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

(c) Changes in internal control over financial reporting

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

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

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

ITEM 11. EXECUTIVE COMPENSATION.

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

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

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

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

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

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

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

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

(a)(3) Exhibits

Exhibit Number	Description of Exhibit
3.1	Amended and Restated Certificate of Incorporation of Spark Networks, Inc. (incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 7, 2010).
3.2	Certificate of Designation of Series C Preferred Stock (incorporated by reference to Exhibit 3.1(A) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
3.3(a)	Amended and Restated Bylaws effective June 7, 2010 of Spark Networks, Inc. (incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 7, 2010).
3.3(b)	Amendment No. 1 to Amended and Restated Bylaws effective August 10, 2011 (incorporated by reference to Exhibit 3.1(a) of the Registrant s Quarterly Report on Form 10-Q filed with the Securities and Exchange on August 11, 2011).
4.1	Rights Plan Dated July 9, 2007 Between Spark Networks, Inc. and The Bank of New York (incorporated by reference to Exhibit 4.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.1(a)	Lease dated September 1, 2000 between Arden Realty Limited Partnership and the Registrant regarding 8383 Wilshire Boulevard (incorporated by reference to exhibit 10.1 of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(b)	First Amendment to Lease, dated September 5, 2000 (incorporated by reference to exhibit 10.1(a) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(c)	Second Amendment to Lease, dated January 16, 2003 (incorporated by reference to exhibit 10.1(b) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(d)	Third Amendment to Lease, dated October 30, 2003 (incorporated by reference to exhibit 10.1(c) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)
10.1(e)	Fourth Amendment to Lease, dated May 14, 2004 (incorporated by reference to exhibit 10.1(d) of MatchNet, Inc. s Registration Statement on Form S-1 (file no. 333-117940) filed with the Securities and Exchange Commission on August 4, 2004)

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Exhibit Number	Description of Exhibit
10.1(f)	Fifth Amendment to Lease, dated January 31, 2006 (incorporated by reference to Exhibit 10.1(e) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).
10.1(g)	Sixth Amendment to Lease, dated February 6, 2007 (incorporated by reference to Exhibit 10.1(f) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 2, 2007).
10.1(h)	Seventh Amendment to Lease, dated November 27, 2007 (incorporated by reference to Exhibit 10.1(g) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2008).
10.1(i)	Eighth Amendment to Lease, dated April 22, 2011.
10.2(a)	2004 Share Option Scheme (incorporated by reference to Exhibit 10.2 of the Registrant s Registration Statement on Form S-1 (File No. 333-123228) filed with the Securities and Exchange Commission on March 10, 2005).
10.2(b)	Amendment to the 2004 Share Option Scheme, dated November 25, 2008 (incorporated by reference to Exhibit d(6) to the Registrant s Schedule TO filed with the Securities and Exchange Commission on December 2, 2008).
10.2(c)	Amendment to the 2004 Option Scheme (incorporated by reference to Exhibit 10.3 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.3	Form of Option Agreement for 2004 Share Option Scheme (incorporated by reference to Exhibit 10.2(a) of the Registrant s Registration Statement on Form S-1/A (File No. 333-123228) filed with the Securities and Exchange Commission on November 14, 2005).
10.4(a)	2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.4(b)	Amendment No. 1 to the 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on January 6, 2009).
10.5	Form of Stock Option Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(A) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.6	Form of Restricted Stock Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(B) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.7	Form of Restricted Stock Unit Agreement for 2007 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6(C) of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.8	Standstill Agreement entered into by the Registrant and Great Hill Equity Partners II on December 1, 2005 (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 7, 2005).
10.9	Consent to Assignment and Assumption of Standstill Agreement with Great Hill Equity Partners II (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).

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Exhibit Number	Description of Exhibit
10.10	Form of Indemnification Agreement with Officers and Directors (incorporated by reference to Exhibit 10.4 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.10(a)	Schedule of Officers and Directors who entered into Indemnification Agreements (incorporated by reference to Exhibit 10.12(a) of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2008).
10.11(a)	Executive Employment Agreement, dated February 12, 2007, between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on February 13, 2007).
10.11(b)	Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
10.11(c)	Amendment No. 2, dated December 29, 2010, to Executive Employment Agreement between the Registrant and Adam S. Berger (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on January 3, 2011).
10.12	Separation Agreement and Release dated April 11, 2011 between Spark Networks, Inc. and Adam S. Berger (incorporated by reference to Exhibit 10.1 of Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on April 12, 2011).
10.13	Executive Employment Agreement, dated April 11, 2011, between the Registrant and Gregory R. Liberman (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on April 12, 2011).
10.14(a)	Employment Agreement dated July 2, 2007 between Spark Networks plc and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.5 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2007).
10.14(b)	Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Joshua A. Kreinberg (incorporated by reference to Exhibit 10.3 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
10.15(a)	Executive Employment Agreement dated May 16, 2007 between Spark Networks plc and Gregory J. Franchina (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 21, 2007).
10.15(b)	Amendment No. 1, dated December 30, 2008, to Executive Employment Agreement between the Registrant and Gregory J. Franchina (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008)
10.16(a)	Executive Employment Agreement executed November 27, 2007 between Spark Networks, Inc. and Brett Zane (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on November 27, 2007).
10.16(b)	Amendment No. 1, dated December 29, 2008, to Executive Employment Agreement between the Registrant and Brett Zane (incorporated by reference to Exhibit 10.5 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 31, 2008).
10.17(a)	Credit Agreement dated February 14, 2008 among Spark Networks Limited, Spark Networks, Inc. and Bank of America, N.A. (incorporated by reference to Exhibit 10.01 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on February 19, 2008).

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Exhibit Number	Description of Exhibit
10.17(b)	First Amendment to Credit Agreement dated as of September 29, 2009 among Spark Networks Limited, Spark Networks, Inc., Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on September 29, 2009).
10.17(c)	Second Amendment to Credit Agreement dated as of February 7, 2011 among Spark Networks Limited, Spark Networks, Inc., Spark Networks USA, LLC, Bank of America, N.A., the other lenders thereto and Banc of America Securities LLC (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on February 8, 2011).
10.17(d)	Third Amendment to Credit Agreement dated as of May 11, 2011 among Spark Networks USA, LLC, Spark Networks, Inc., and Bank of America, N.A. (incorporated by reference to Exhibit 10.1 of the Registrant s Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 12, 2011).
21.1	List of subsidiaries (incorporated by reference to Exhibit 21.1 of the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 25, 2011).
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

* 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.

** Attached as Exhibits 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language). Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Beverly Hills, State of California, on March 27, 2012.

SPARK NETWORKS, INC.

/s/ Gregory R. Liberman
Gregory R. Liberman
Chief Executive Officer

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

Name	Position	Date
/s/ Gregory R. Liberman Gregory R. Liberman	Chief Executive Officer (Principal Executive Officer) and Director	March 27, 2012
/s/ Brett A. Zane Brett A. Zane	Chief Financial Officer (Principal Financial and Accounting Officer)	March 27, 2012
/s/ Jonathan B. Bulkeley Jonathan B. Bulkeley	Director	March 27, 2012
/s/ Benjamin A. Derhy Benjamin A. Derhy	Director	March 27, 2012
/s/ Michael A. Kumin Michael A. Kumin	Director	March 27, 2012
/s/ Thomas G. Stockham Thomas G. Stockham	Director	March 27, 2012
/s/ Adam S. Berger Adam S. Berger	Director	March 27, 2012
/s/ Peter L. Garran Peter L. Garran	Director	March 27, 2012

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Spark Networks, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spark Networks, Inc. at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Los Angeles, California

March 27, 2012

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SPARK NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except stock data)

	December 31, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 15,106	$ 13,901
Restricted cash	958	996
Accounts receivable, net of allowance of $1 and $9	1,146	847
Deferred tax asset current	44	43
Prepaid expenses and other	1,164	911
Total current assets	18,418	16,698
Property and equipment, net	2,839	2,520
Goodwill	8,683	9,156
Intangible assets, net	1,900	3,017
Deferred tax asset non-current	5,641	4,882
Deposits and other assets	455	295
Total assets	$ 37,936	$ 36,568
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 952	$ 1,371
Accrued liabilities	4,046	3,635
Deferred revenue	5,723	4,331
Deferred tax liability current portion	203	
Total current liabilities	10,924	9,337
Deferred tax liability	1,219	825
Other liabilities non-current	1,141	1,036
Total liabilities	13,284	11,198
Commitments and contingencies (Note 12)		
Stockholders equity:		
Authorized capital stock consists of 10,000,000 shares of Preferred Stock, $0.001 par value, 450,000 of which are designated as Series C Junior Participating Cumulative Preferred Stock, with no shares of Preferred Stock issued or outstanding and 100,000,000 shares of Common Stock, $0.001 par value, with 20,594,670 and 20,587,336 shares of Common Stock issued and outstanding at December 31, 2011 and 2010, respectively.	21	21
Additional paid-in-capital	53,014	52,020
Accumulated other comprehensive income.	672	773
Accumulated deficit	(29,055)	(27,444)
Total stockholders equity	24,652	25,370
Total liabilities and stockholders equity	$ 37,936	$ 36,568

See accompanying notes.

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Years Ended December 31, 2011	2010	2009
Revenue	$ 48,493	$ 40,851	$ 45,388
Cost and expenses:			
Cost of revenue (exclusive of depreciation shown separately below)	28,955	13,749	15,207
Sales and marketing	3,722	3,496	3,507
Customer service	1,980	1,601	1,832
Technical operations	1,367	1,232	1,504
Development	2,710	3,092	3,895
General and administrative	8,068	9,782	9,932
Depreciation	1,320	962	873
Amortization of intangible assets other than goodwill	370	421	663
Impairment of goodwill, long-lived assets and other assets	1,145	308	11,999
Total cost and expenses	49,637	34,643	49,412
Operating (loss) income	(1,144)	6,208	(4,024)
Interest expense (income) and other, net	162	(54)	(1,099)
(Loss) income before income taxes	(1,306)	6,262	(2,925)
Provision for income taxes	305	2,558	3,479
Net (loss) income	$ (1,611)	$ 3,704	$ (6,404)
Net (loss) income per share basic and diluted	$ (0.08)	$ 0.18	$ (0.31)
Weighted average shares outstanding basic	20,591	20,586	20,570
Weighted average shares outstanding diluted	20,591	20,590	20,570

Stock-Based Compensation (in thousands)	**Years Ended December 31, 2011**	**2010**	**2009**
Cost of revenue	$ 8	$ 11	$ 17
Sales and marketing	80	233	184
Customer service		1	(14)
Technical operations	119	167	158
Development	42	54	29
General and administrative	657	1,044	667

See accompanying notes.

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Ordinary Shares/ Common Stock			Accumulated		
	Shares	Amount	Additional Paid-in Capital	Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
BALANCE, December 31, 2008	20,542	$ 21	$ 45,545	$ 591	$ (24,744)	$ 21,413
Issuance of common stock upon exercise of stock options	40		30			30
Excess tax benefits from stock-based comp			2,197			2,197
Foreign currency translation adjustment, net of tax				47		47
Stock-based compensation			1,041			1,041
Net loss					(6,404)	(6,404)
BALANCE, December 31, 2009	20,582	$ 21	$ 48,813	$ 638	$ (31,148)	$ 18,324
Issuance of common stock upon exercise of stock options	5		17			17
Excess tax benefits from stock-based comp			1,680			1,680
Foreign currency translation adjustment, net of tax				135		135
Stock-based compensation			1,510			1,510
Net income					3,704	3,704
BALANCE, December 31, 2010	20,587	$ 21	$ 52,020	$ 773	$ (27,444)	$ 25,370
Issuance of common stock upon exercise of stock options	8		21			21
Excess tax benefits from stock-based comp			67			67
Foreign currency translation adjustment, net of tax				(101)		(101)
Stock-based compensation			906			906
Net loss					(1,611)	(1,611)
BALANCE, December 31, 2011	20,595	$ 21	$ 53,014	$ 672	$ (29,055)	$ 24,652

See accompanying notes.

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SPARK NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years Ended December 31,		
	2011	**2010**	**2009**
Cash flows from operating activities:			
Net (loss) income	$ (1,611)	$ 3,704	$ (6,404)
Adjustments to reconcile net (loss) income to cash provided by operating activities:			
Depreciation and amortization	1,690	1,383	1,536
Impairment of goodwill, long-lived assets and other assets	1,145	308	11,999
Stock-based compensation	906	1,510	1,041
Non-current taxes payable and other	96	46	(42)
Foreign exchange gain on intercompany loan	337	(269)	(30)
Income from asset received from legal judgment	(247)		(1,507)
Excess tax benefits from stock-based compensation	(67)	(1,680)	(3,207)
Deferred taxes	(96)	1,843	2,232
Changes in operating assets and liabilities:			
Accounts receivable	(299)	(163)	418
Restricted cash	38	(315)	84
Prepaid expenses and other assets	(128)	(31)	1,089
Accounts payable and accrued liabilities	(100)	(641)	(1,443)
Deferred revenue	1,392	87	151
Net cash provided by operating activities	3,056	5,782	5,917
Cash flows from investing activities:			
Sale of property and equipment		1,560	
Purchases of property and equipment	(1,583)	(1,324)	(1,440)
Purchases of businesses and intangible assets	(356)	(37)	(32)
Earn out payment for acquisition of business			(1,355)
Net cash (used in) provided by investing activities	(1,939)	199	(2,827)
Cash flows from financing activities:			
Proceeds from issuance of stock	21	17	30
Excess tax benefits from stock-based compensation	67	1,680	3,207
Payment on revolving credit facility borrowing			(7,500)
Payment of deferred financing costs			(21)
Net cash provided by (used in) financing activities	88	1,697	(4,284)
Net increase (decrease) in cash	1,205	7,678	(1,194)
Cash and cash equivalents at beginning of year	13,901	6,223	7,417
Cash and cash equivalents at end of year	$ 15,106	$ 13,901	$ 6,223
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	$	$ 159
Cash paid for income taxes	$ 192	$ 874	$ 1,232
Supplemental disclosure of non-cash investing and financing activities:			
Hold-back in acquisition of business	$	$	$ (250)

See accompanying notes.

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

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 and its consolidated subsidiaries provide online personals services in the United States and internationally, whereby adults are able to post information about themselves (profiles) on the Company s Web sites and search and contact other individuals who have posted profiles.

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

Principles of Consolidation

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

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

The nature of the intercompany loan between the Company and its Israel subsidiary is classified as a loan which the Company expects to be settled. The foreign exchange gains and losses related to this loan are recorded as part of net income and excluded from accumulated other comprehensive income (loss). For the years ended December 31, 2011 and 2010, the Company recorded a foreign exchange loss of approximately $337,000 and a gain of $269,000 related to the intercompany loan, respectively.

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

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue Recognition and Deferred Revenue

Substantially all of the Company s revenue is derived from subscription fees. Revenue is presented net of credits and credit card chargebacks. The Company recognizes revenue in accordance with accounting principles generally accepted in the United States. Revenue recognition occurs ratably over the subscription period, beginning when there is persuasive evidence of an arrangement, delivery has occurred (access has been granted), the fees are fixed or determinable, and collection is reasonably assured. Subscribers pay in advance, primarily by using a credit card, and, subject to certain conditions identified in our terms and conditions, all purchases are final and nonrefundable. Fees collected in advance for subscriptions are deferred and recognized as revenue using the straight line method over the term of the subscription.

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

Fair Value Measurement

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

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

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

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

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

As of December 31, 2011 and 2010, the Company had financial assets that consisted of cash and cash equivalents, which were measured at fair value using quoted prices for identical assets in an active market (Level 1 fair value hierarchy) in accordance with the latest guidance.

Cash and Cash Equivalents

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

Restricted Cash

The Company s credit card processors regularly withhold deposits and maintain balances which the Company records as restricted cash. As of December 31, 2011 and 2010, the Company had $958,000 and $996,000 in restricted cash, respectively.

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounts Receivable

Accounts receivable is primarily composed of credit card payments for subscription fees pending collection from the credit card processors and to a much smaller extent, receivables for advertising sales. The Company records a reserve based on historical chargeback levels experienced over the preceding three-month period and reviews its accounts receivable from advertisers on a monthly basis. The allowance for doubtful accounts as of December 31, 2011 and 2010 is $1,000 and $9,000, respectively.

Prepaid Advertising Expenses

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

Web Site and Software Development Costs

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

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

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

	2011	2010	2009
Capitalized	$ 1,250	$ 1,100	$ 874
Expensed	(850)	(504)	(176)
Impairment	(45)	(121)	(110)
Unamortized Balance	$ 1,976	$ 1,621	$ 1,146

Property and Equipment

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

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired resulting from business acquisitions, specifically allocated to reporting units. The Company determines its reporting unit and operating segment through the use of the management approach. The management approach considers the internal organizational structure used by the Company s chief operating decision maker for making operating decisions and assessing performance. Annually, the Company analyzes the fair value of each reporting unit to assess if the fair value exceeds the carrying value. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices or appraised values, depending on the nature of the assets. If fair value is below the carrying amount of the reporting unit, the Company assesses what the fair value of the reporting unit is and impairs the excess. The valuation of intangible assets incorporates significant unobservable inputs and requires estimates, including the amount and timing of future cash flows. As of December 31, 2011 and 2010, the Company had unamortized goodwill of approximately $8.7 million and $9.2 million, respectively.

Intangible Assets

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

In 2011 and 2010, largely based on the valuation of domain names and capitalized software acquired from prior period acquisitions, the Company recorded an impairment charge of approximately $1.1 million and $187,000, respectively, for intangible assets it deemed to not have substantial value.

Impairment of Long-lived Assets

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

If events and circumstances indicate that the carrying amount of an asset may not be recoverable and the expected undiscounted future cash flows attributable to the asset are less than the carrying amount of the asset, an impairment loss equal to the excess of the asset s carrying value over its fair value is recorded. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices or appraised values, depending on the nature of the assets. Fair value measurements utilized for assets under non recurring measurements were measured with Level 3 unobservable inputs.

For the years 2011, 2010 and 2009, the Company impaired approximately $45,000, $121,000 and $110,000, respectively, of capitalized software development costs when management determined that a web-based product failed to perform to Company standards.

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

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

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

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

Cost of Revenue

Cost of revenue consists primarily of direct marketing costs, compensation and other employee-related costs (including stock-based compensation) for personnel dedicated to maintaining our data centers, data center expenses and credit card fees. Direct marketing costs are expensed in the period incurred and primarily represent online marketing, including payments to search engines and affiliates, and offline marketing, including radio, billboards, television and print advertising. For the years ended December 31, 2011, 2010 and 2009, the Company incurred direct marketing costs amounting to approximately $25.7 million, $10.7 million and $12.1 million, respectively.

Sales and Marketing

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

Customer Service

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

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Technical Operations

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

Development

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

General and Administrative

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

Stock-based Compensation

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

Prior to our adoption of the guidance, the Company did not record tax benefits of deductions resulting from the exercise of share options because of the uncertainty surrounding the timing of realizing the benefits of our deferred tax assets in future tax returns. The guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. In 2011 and 2010, the Company recognized cash inflows of approximately $67,000 and approximately $1.7 million, respectively, related to a tax benefit from stock-based compensation.

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

	2011	2010	2009
Expected life in years	4.56	4.56	4.56
Dividend per share			
Volatility	35.0-45.0%	40.0-45.0%	40.0-45.0%
Risk-free interest rate	1.4-3.0%	1.0-3.0%	2.0-3.0%

The Company used historical and empirical data to assess different forfeiture rates for three different groups of employees. The Company must reassess forfeiture rates when deemed necessary and it must calibrate actual forfeiture behavior to what has already been recorded. For 2011, 2010 and 2009, there were three groups of employees whose behavior was significantly different from each other. Therefore, the Company estimated different forfeiture rates for each group.

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

Due to the repricing of most options in 2009, the Company is using the simplified method calculation to determine the term of the options. The simplified method calculation derives the term by averaging the vesting term with the contractual terms. Option awards to date have generally vested and been expensed in equal annual instalments over a four-year period.

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Comprehensive (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 (loss) income consists of its reported net (loss) income and translation adjustments. Comprehensive (loss) income for each of the periods presented is comprised as follows:

	Years Ended December 31, (in thousands)		
	2011	2010	2009
Net (loss) income	$ (1,611)	$ 3,704	$ (6,404)
Foreign currency translation adjustment	(101)	135	47
Total comprehensive (loss) income	$ (1,712)	$ 3,839	$ (6,357)

Accumulated other comprehensive (loss) income consists of foreign currency translation as follows:

	As of December 31, (in thousands)		
	2011	2010	2009
Foreign currency translation adjustment	$ 672	$ 773	$ 638
Total accumulated other comprehensive income	$ 672	$ 773	$ 638

Fair Value of Financial Instruments

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

Net (Loss) Income Per Share

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

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Year Ended December 31 (in thousands except per share amounts)		
	2011	**2010**	**2009**
Net (Loss) Income Per Common Share Basic			
Net (loss) income applicable to common stock	$ (1,611)	$ 3,704	$ (6,404)
Weighted average shares outstanding-basic	20,591	20,586	20,570
Basic Net (Loss) Income Per Share	**$ (0.08)**	**$ 0.18**	**$ (0.31)**
Net (Loss) Income Per Common Share Diluted			
Net (loss) income applicable to common stock	$ (1,611)	$ 3,704	$ (6,404)
Weighted average shares outstanding-basic	20,591	20,586	20,570
Dilutive options using the treasury stock method		4	
Weighted average shares outstanding-diluted	20,591	20,590	20,570
Diluted Net (Loss) Income Per Share	**$ (0.08)**	**$ 0.18**	**$ (0.31)**

Options to purchase 3.5 million, 3.3 million and 3.4 million shares for fiscal years 2011, 2010 and 2009, respectively, were not included in the computation of diluted net income per share because the options were anti-dilutive.

Use of Estimates

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

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

Recent Accounting Developments

In May 2011, the FASB issued a new accounting standard update, which amends the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for fiscal years beginning after December 15, 2011. We adopted this standard in the first quarter of 2012 and the adoption will not have a material impact on our financial statements and disclosures.

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. In addition, in December 2011, the FASB issued an amendment to an existing accounting standard

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The new guidance will be effective for the Company beginning January 1, 2012 and will only impact the presentation of financial statements.

In September 2011, the FASB issued an amendment to an existing accounting standard, which provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We adopted this standard in the first quarter of 2012 and the adoption will not have a material impact on our financial statements.

2. Income Taxes

(Loss) income before income taxes	Year Ended December 31,		
(in thousands)	**2011**	**2010**	**2009**
U.S	$ (619)	$ 5,986	$ (2,978)
Foreign	(687)	276	53
	$ (1,306)	$ 6,262	$ (2,925)

Provision (benefit) for income taxes	Year Ended December 31,		
(in thousands)	**2011**	**2010**	**2009**
Current			
Federal	$ (326)	$ 1,920	$ 3,769
State	638	518	638
Foreign	69	2	52
	381	2,440	4,459
Deferred			
Federal	50	60	(1,145)
State	(160)	35	210
Foreign	477	115	(92)
	367	210	(1,027)
Valuation Allowance	(443)	(92)	47
	$ 305	$ 2,558	$ 3,479

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reconciliation of Effective Income Tax Rate:	Year Ended December 31, 2011	2010	2009
Provision on earnings at federal statutory rate	34.0%	34.0%	34.0%
State tax provision, net of federal benefit	(6.0)	4.8	5.8
Goodwill Impairment			(126.4)
Nondeductible expenses	(0.3)	0.3	(1.9)
Tax reserves	1.3	0.6	(1.6)
Change in effective tax rates	(18.6)	0.3	(6.9)
Foreign tax rate differential	(9.6)	(4.3)	(9.7)
Valuation allowance	8.9	3.0	(1.6)
Write down of deferred tax asset	(34.1)		(10.2)
Other	1.1	2.2	(0.4)
Total (benefit) provision for income taxes	(23.3)%	40.9%	(118.9)%

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

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

(in thousands)	**Year Ended December 31, 2011**	**2010**	**2009**
Net operating loss carry-forward	$ 782	$ 940	$ 691
Depreciation and amortization	1,655	1,383	1,546
Compensation accruals	2,590	2,234	2,022
Credits	913	905	793
Other	496	534	776
Total before valuation allowance	6,436	5,996	5,828
Less: Valuation allowance	(649)	(805)	(617)
Total deferred income tax asset	5,787	5,191	5,211
Deferred income tax liabilities			
Foreign Intangible assets	(1,205)	(814)	(649)
Other	(319)	(277)	(297)
Total deferred income tax liabilities	(1,524)	(1,091)	(946)
Total net deferred income tax assets	$ 4,263	$ 4,100	$ 4,265

Due to uncertainty with regard to the Company s ability to realize certain deferred tax assets, the Company has maintained a valuation allowance of approximately $649,000 against its deferred tax assets as of December 31, 2011.

Although realization is not assured, the Company has concluded that it is more likely than not that the deferred tax assets at December 31, 2011 for which a valuation allowance was determined to be unnecessary will be realized in the ordinary course of operations based on the available positive and negative evidence, primarily the

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company s projected earnings. The amount of the net deferred tax assets considered realizable, however, could be reduced in the near term if actual future earnings or income tax rates are lower than estimated, or if there are differences in the timing or amount of future reversals of existing taxable or deductible temporary differences.

At December 31, 2011, the Company has gross net operating loss carry-forwards (NOL) for income tax purposes of approximately $8.5 million and $36.4 million available to reduce future federal and state taxable income, respectively, which expire beginning in the years 2025 for federal purposes and 2018 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.

At December 31, 2011, the Company also has net operating loss carryovers for Israeli tax purposes of approximately $2.3 million.

At December 31, 2011, the Company has federal income tax credit carry-forwards for income tax purposes of approximately $900,000 available to reduce future federal income tax.

The Company recognizes excess tax benefits associated with the exercise of stock options directly to stockholders equity only when realized. Accordingly, deferred tax assets are not recognized for NOL resulting from excess tax benefits. As of December 31, 2011, deferred tax assets do not include approximately $4.8 million of these excess tax benefits from employee stock option exercises that are a component of the Company s net operating loss carry forwards. Accordingly, additional paid-in-capital will be increased up to an additional $4.8 million if and when such excess tax benefits are realized. During 2011, approximately $67,000 related to net excess tax benefits were realized.

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

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

(in thousands)	**2011**	**2010**	**2009**
Balance at January 1,	$ 839	$ 839	$ 839
Additions based on tax positions related to the current year			
Additions for tax positions of prior years	463		
Reductions for tax positions of prior years	(327)		
Settlements			
Balance at December 31,	$ 975	$ 839	$ 839

Included in the unrecognized tax benefits of $1.0 million at December 31, 2011 was $800,000 of tax benefits that, if recognized, would reduce our annual effective tax rate.

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

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2011 and 2010, the Company had recorded a $165,000 and $196,000 accrual for interest and penalties on unrecognized tax benefits, respectively. Interest expenses of ($31,000), $58,000 and $72,000 were recognized in the years ended December 31, 2011, 2010 and 2009, respectively. The Company does not expect any significant decreases to its unrecognized tax benefit within the next 12 months.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years before 2008; state and local income tax examinations before 2007; and foreign income tax examinations before 2007. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carry forward amount.

4. Property and Equipment

Property and equipment consists of the following:

(in thousands)	As of December 31, 2011	2010
Computer equipment	$ 1,868	$ 3,258
Computer software	4,831	3,992
Furniture, fixtures and equipment	592	665
Leasehold Improvements	691	697
	7,982	8,612
Less: Accumulated depreciation	(5,143)	(6,092)
	$ 2,839	$ 2,520

Depreciation expense, for the years ended December 31, 2011 and 2010, was $1.3 million and $962,000, respectively, and is calculated on the straight-line basis over three years.

5. Goodwill and Other Intangible Assets

Jewish Networks and Other Affinity Networks are the only reporting units with goodwill balances. Jewish Networks goodwill balance at December 31, 2011 and 2010 was $6.8 million and $7.3 million, respectively. Other Affinity Networks goodwill balance at December 31, 2011 and 2010 was $1.9 million. The following table shows the activity and balances related to goodwill from January 1, 2010 to December 31, 2011:

(in thousands)	Gross Goodwill	Accumulated Impairments	Net Goodwill
Balance at January 1, 2010	$ 22,492	$ (13,734)	$ 8,758
Foreign currency	398(1)		398
Balance at December 31, 2010	$ 22,890	$ (13,734)	$ 9,156
Foreign currency	(473)(1)		(473)
Balance at December 31, 2011	$ 22,417	$ (13,734)	$ 8,683

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

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2011 and 2010, the Company performed its annual impairment analysis and determined the fair value of each reporting unit and compared it to the carrying amount of the reporting unit. Fair value of the reporting unit was based on the market approach and income approach. The income approach relies upon discounted future cash flows which are derived from various assumptions including; projected cash flows, discount rates, projected long-term growth rates and terminal values. The Company used a discount rate which reflects the risks and uncertainty related to each reporting unit. The analysis concluded that the estimated fair value of the Jewish Networks business was higher than its carrying value and the estimated fair value of the Other Affinity Networks business was higher than its carrying value. At the conclusion of the analysis, it was determined that impairment was not warranted.

In 2009, we performed our annual impairment analysis and determined the fair value of each reporting unit and compared it to the carrying amount of the reporting unit. The fair value of the Jewish Networks reporting unit was higher than the carrying value as of December 31, 2009 and thus did not require any impairment. Based upon several valuation assumptions, including lower expected performance and lower industry multiples, the analysis concluded that the carrying value of the Other Affinity Networks business was higher than its estimated fair value. As a result, the Company performed the second step under the guidance to assess the fair value of the assets and liabilities of Other Affinity Networks. The analysis resulted in impairment to goodwill and domain names of $9.3 million and $1.3 million, respectively. In 2009, we paid the final $1.4 million in earn-out payments for the acquisition of the HurryDate business in 2007. The earn-out payments were recorded as impairment expense based on business performance. There were no additional impairments as a result of the assessment.

Goodwill of $8.7 million and $9.2 million, as of December 31, 2011 and 2010 respectively, is mainly related to the purchase of Pointmatch in January 2004, MingleMatch, Inc. in May 2005, and LDSSingles in May 2006. Finite-lived intangible assets consist of purchased databases and technologies, and are amortized over the expected periods of benefits (three years for member databases, three months for subscriber databases and five years for technologies). Indefinite-lived intangible assets, consisting of purchased domain names, are not amortized. Intangible assets consist of the following:

	As of December 31, 2011		As of December 31, 2010	
(in thousands)	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Member databases	$ 3,040	$ (3,040)	$ 3,448	$ (3,448)
Purchased technologies	1,200	(1,187)	2,332	(1,568)
Domain names	1,887		2,253	
	$ 6,127	$ (4,227)	$ 8,033	$ (5,016)

Amortization expense for finite-lived intangible assets for the year ended December 31, 2011 and 2010 was $370,000 and $421,000, respectively. Amortization expense is expected to be $13,000 for the year ending December 31, 2012. In 2011 and 2010, the Company determined that certain domain names and computer software acquired from prior period acquisitions had no value based upon the expected future cash flows generated from the businesses associated with these assets, resulting in impairment charges of approximately $1.1 million and $187,000 respectively.

6. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31, 2011	December 31, 2010
	(in thousands)	
Advertising	$ 1,452	$ 866
Accrued compensation	1,905	1,586

Other accrued liabilities	689	1,183
Total	$ 4,046	$ 3,635

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 has recorded it at fair value less the anticipated cost of sale.

In the year ended December 31, 2009, the Company became the record title owner of real property purchased in a sheriff s sale to partially satisfy the Company s outstanding judgment against Will Knedlik and recorded other income of $1.5 million in Interest expense (income) and other, net on the Consolidated Statements of Operations. On February 1, 2010, the Company entered into a purchase agreement to sell such real property. The Company closed the transaction in the second quarter of 2010.

8. Notes Payable

Revolving Credit Facility

The Company and its wholly-owned subsidiary, Spark Networks USA, LLC, have 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 December 31, 2011.

As of December 31, 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 year ended December 31, 2011 and December 31, 2010 were $56,000 and $141,000, respectively.

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Stockholders Equity

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.

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 December 31, 2011, total unrecognized compensation cost related to non-vested stock options was $1.2 million. This cost is expected to be recognized over a weighted-average period of 3 years. The following table describes option activity for the years ended December 31, 2011, 2010 and 2009:

	Years Ended December 31,		
	2011	**2010**	**2009**
Granted, weighted average fair value per share	$ 1.02	$ 1.07	$ 0.79
Exercised, weighted average intrinsic value per share	$ 0.32	$ 0.46	$ 1.63
Aggregate intrinsic value of options outstanding and exercisable (in thousands)	$ 1,571	$ 371	$ 0

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

	Number of Shares	**Weighted Average Price per Share**
Outstanding at December 31, 2009	3,387	$ 3.28
Granted	210	2.99
Exercised	(5)	3.00
Expired	(124)	4.50
Forfeited	(104)	3.22
Outstanding at December 31, 2010	3,364	$ 3.12
Granted	700	3.19
Exercised	(8)	2.96

Expired	(10)	3.30
Forfeited	(463)	2.99
Outstanding at December 31, 2011	3,583	3.14

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Option Range Summary

As of December 31, 2011

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price
$3.18 - $7.77	893	5	$ 3.62	304	4	$ 4.45
$3.00	2,551	6	$ 3.00	2,082	6	$ 3.00
$2.18 - $2.99	139	5	$ 2.53	82	4	$ 2.57
	3,583	6	$ 3.14	2,468	6	$ 3.16

As of December 31, 2010

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Life	Weighted Average Exercise Price
$3.91 - $8.60	193	3	$ 5.19	172	3	$ 5.27
$3.00	3,019	7	$ 3.00	1,664	7	$ 3.00
$2.18 - $2.99	152	5	$ 2.55	47	5	$ 2.60
	3,364	7	$ 3.12	1,883	7	$ 3.20

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

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 expenses recognized for the years ended December 31, 2011, 2010 and 2009 were $172,000, $339,000 and $286,000, respectively.

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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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Employee Benefit Plan

The Company has a defined contribution plan under Section 401(k) of the Internal Revenue Code covering all full-time employees, and providing for matching contributions by the Company, as defined in the plan. Participants in the plan may direct the investment of their personal accounts to a choice of mutual funds consisting of various portfolios of stocks, bonds, or cash instruments. Contributions made by the Company to the plan for the years ended December 31, 2011, 2010 and 2009 were approximately $338,000, $333,000 and $343,000, respectively.

11. Segment Information

Segment reporting requires the use of the management approach in determining the reportable operating segments. The management approach considers the internal organization and reporting used by our chief operating decision maker for making operating decisions and assessing performance. The Company s financial reporting includes detailed data on four separate reportable segments which were principally determined based on similarity of economic characteristics. For the periods covered by the financial statements in this report, the Company s financial reporting data consists of 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 websites; (2) General Market Networks, which consists of AmericanSingles.com and Date.ca, which were both rebranded as Spark.com in December of 2009 and Date.co.uk which was rebranded as Spark.com in February 2010 and their respective co-branded and private label websites; (3) 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 (4) Offline & Other Businesses, which consists of revenue generated from offline activities, HurryDate events and subscriptions, and other websites and businesses.

	Years Ended December 31		
(in thousands)	**2011**	**2010**	**2009**
Revenue			
Jewish Networks	$ 27,054	$ 27,440	$ 28,842
Other Affinity Networks	20,089	11,279	12,771
General Market Networks	578	1,168	2,692
Offline and Other Businesses	772	964	1,083
Total Revenue	$ 48,493	$ 40,851	$ 45,388
Direct Marketing Expenses			
Jewish Networks	$ 3,389	$ 2,321	$ 2,346
Other Affinity Networks	21,459	7,292	8,502
General Market Networks	364	582	676
Offline and Other Businesses	512	535	541
Total Direct Marketing Expenses	$ 25,724	$ 10,730	$ 12,065
Unallocated Operating Expense	23,913	23,913	37,347
Operating (Loss) Income	**$ (1,144)**	**$ 6,208**	**$ (4,024)**

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	Years Ended December 31		
(in thousands)	**2011**	**2010**	**2009**
Revenue			
United States	$ 44,358	$ 36,849	$ 41,413
Israel	4,135	4,002	3,975
Total Revenue	$ 48,493	$ 40,851	$ 45,388

	As of December 31,	
	2011	**2010**
Non-Current Assets		
United States	$ 3,117	$ 2,583
Israel	177	232
Total	**$ 3,294**	**$ 2,815**

Segment Reclassification

During the first quarter of 2012, the Company changed management s internal reporting to include data on four newly-defined operating segments: Jewish Networks, which consists of JDate.com, JDate.co.il, Cupid.co.il, and their respective co-branded Web sites; Christian Networks, which consists of ChristianMingle.com, ChristianMingle.co.uk, ChristianMingle.com.au and Believe.com;; Other Networks, which consists of Spark.com and properties which are primarily made up of sites targeted towards various religious, ethnic, geographic and special interest groups; and Offline & Other Businesses, which consists of revenue generated from offline activities and HurryDate events and subscriptions. The Company believes the new segments will provide investors with greater transparency into the performance of the business.

12. Commitments and Contingencies

Operating Leases

The Company leases its office facilities under operating lease agreements effective through July 2017, providing for annual minimum lease payments as follows (amounts in thousands):

Year Ending	
2012	$ 623

2013	378
2014	188
2015	194
2016	200
2017	120
Total	**$ 1,703**

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

The Company recognized rent expense under operating leases of $1.0 million, $1.3 million and $1.3 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Other Commitments and Obligations

The Company has other commitments and obligations consisting of contracts with software licensing, communications, computer hosting and marketing service providers. These amounts totaled $321,000 for less than one year and $321,000 between one and three years. Contracts with other service providers are for 30 day terms or less.

Year Ending (amounts in thousands)	
2012	$ 321
2013	321
Total	$ 642

Legal Proceedings

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. Oral argument was held on December 8, 2011. Per the Fifth Circuit s request, the parties submitted supplemental briefs on December 16, 2011. On March 21, 2012, the Fifth Circuit issued its opinion affirming the District Court s dismissal of certain claims and reversing the dismissal of certain other claims.

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

On March 11, 2010, L.I.S.T. Incorporated initiated a class action lawsuit against Spark Networks, Inc., Adam S. Berger, Jonathan B. Bulkeley, Benjamin Derhy, Thomas G. Stockham, Michael A. Kumin, Great Hill Equity Partners III, LP and Great Hill Partners, LLC in the Court of Chancery of the State of Delaware, alleging breach

SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of fiduciary duty. The action arises out of the proposal by Great Hill Partners III, LP to purchase all of the shares of Spark Networks, Inc. that it does not already own. On September 10, 2010, the Company announced that the Board of Directors had disbanded the Special Committee of independent directors which had been formed to consider the proposal made by Great Hill to purchase all of the outstanding shares of common stock of the Company not owned by Great Hill and other strategic alternatives available to the Company. The action initiated by L.I.S.T. was dismissed by plaintiff without prejudice on March 4, 2011.

Ness Interactive v. Spark Networks Limited

On January 22, 2010, Spark Networks Limited was served with a complaint from Ness Interactive alleging that Spark Networks engaged in unfair competition by bidding on certain online advertising keywords in France. Spark Networks Limited filed its initial response on October 15, 2010 and counterclaimed that Ness engaged in unfair competition. The parties settled the case and it was dismissed by the court on May 6, 2011.

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

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

13. Related Party Transactions

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

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recapitalization, restructuring, dissolution or other extraordinary transaction if (1) prior to giving effect thereto, the Great Hill group beneficially owns less than 60% of Total Voting Power and (2) after giving effect, the Great Hill Group would beneficially own more than 29.9% of Total Voting Power.

On March 2, 2010, the Company granted a partial waiver of the Standstill Agreement to the extent necessary to allow the Special Committee of the Board of Directors to receive, discuss and negotiate a proposal by the Great Hill Group to purchase all of the outstanding shares of common stock of the Company not owned by the Great Hill Group, at a cash purchase price of $3.10 per share. The waiver automatically (but not retroactively) terminated when, on September 10, 2010, the Company announced that the Board of Directors had disbanded the Special Committee of independent directors which had been formed to consider the proposal made by Great Hill to purchase all of the outstanding shares of common stock of the Company not owned by Great Hill and other strategic alternatives available to the Company.

In December 2011, the Company entered into an agreement with Latisys-Irvine, Inc., a collocation and data center provider to provide collocation, cages, connectivity and other related equipment and services. Great Hill Partners, an owner of more than 5% of the Company s stock, has informed the Company that it has an ownership position in Latisys-Irvine, Inc.

In January 2012, the Company entered into an agreement with Ultra Unlimited Corp., a software development firm, to provide the Company with certain software. The Chief Executive Officer of Ultra UnlimitedCorp. is the brother of Michael Kumin, a director of the Company, and Michael Kumin and Jonathan Bulkeley, also a director of the Company, have informed the Company that they are individual investors in Ultra Unlimited Corp.

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SPARK NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Quarterly Results of Operations (unaudited)

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

	Three Months Ended							
(in thousands, except per share amount)	Dec. 31, 2011	Sept. 30, 2011	June 30, 2011	March 31, 2011	Dec. 31, 2010	Sept. 30, 2010	June 30, 2010	March 31, 2010
Consolidated Statement of Operations Data:								
Revenue	$ 12,861	$ 12,677	$ 11,995	$ 10,960	$ 10,109	$ 9,916	$ 10,289	$ 10,537
Cost of revenue	8,420	7,373	7,347	5,815	4,002	3,206	3,384	3,157
Sales and marketing	1,062	923	837	900	788	774	851	1,083
Customer service	539	531	449	461	420	403	382	396
Technical operations	281	336	336	414	302	252	315	363
Development	643	643	679	745	760	773	778	781
General and administrative	1,071	2,435	2,199	2,363	2,141	2,316	2,538	2,787
Depreciation	343	341	346	290	263	242	222	235
Amortization	89	90	93	98	97	98	104	122
Impairment of goodwill and other assets	1,100	45			187			121
Total operating expenses	13,548	12,717	12,286	11,086	8,960	8,064	8,574	9,045
(Loss) income from operations	(687)	(40)	(291)	(126)	1,149	1,852	1,715	1,492
Interest expense (income) and other, net	144	120	(45)	(57)	(72)	(182)	241	(41)
(Loss) income before income taxes	(831)	(160)	(246)	(69)	1,221	2,034	1,474	1,533
Provision for income taxes	277	78	(165)	115	595	808	551	604
Net (loss) income	$ (1,108)	$ (238)	$ (81)	$ (184)	$ 626	$ 1, 226	$ 923	$ 929
Basic and diluted net (loss) income per share	$ (0.05)	$ (0.01)	$ (0.00)	$ (0.01)	$ 0.03	$ 0.06	$ 0.04	$ 0.05
Shares used in computation of basic net (loss) income per share	20,595	20,595	20,589	20,587	20,587	20,587	20,587	20,582
Shares used in computation of diluted net (loss) income per share	20,595	20,595	20,589	20,587	20,588	20,590	20,598	20,582

15. Subsequent Events

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