

SPARK NETWORKS PLC

Form 10-K

March 13, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____
COMMISSION FILE NO. 000-51195
SPARK NETWORKS PLC
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

ENGLAND AND WALES
*(State or other jurisdiction of
incorporation or organization)*

98-0200628
*(I.R.S. Employer
Identification No.)*

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

90211

(Address of principal executive offices)

(Zip Code)

**REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (323) 836-3000
SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

Title of Each Class	Name of Each Exchange on Which Registered
Ordinary Shares, par value £0.01 per share	American Stock Exchange

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

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

As of June 30, 2005, the aggregate market value of the registrant's ordinary shares held by non-affiliates of the registrant was approximately \$74,607,102 based on the closing sale price of the ordinary shares in the form of Global Depositary Shares as reported on the Frankfurt Stock Exchange. The registrant's American Depositary Shares were approved for listing on the American Stock Exchange in February 2006. Ordinary shares held by each officer and director and by each person who owns 10% or more of the outstanding ordinary shares have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The registrant had 30,247,996 outstanding ordinary shares, par value £0.01 per share, as of February 1, 2006.

No documents are incorporated herein by reference.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K, including the sections entitled Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and Business, contains forward-looking statements that involve substantial risks and uncertainties. All statements other than statements of historical facts contained in this annual

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report on Form 10-K, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as believes, expects, anticipates, intends, estimates, may, v continue, should, plan, predict, potential or the negative of these terms or

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other similar expressions. We have based these forward-looking statements on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Our actual results could differ materially from those anticipated in these forward-looking statements, which are subject to a number of risks, uncertainties and assumptions described in Risk Factors section and elsewhere in this Form 10-K, regarding, among other things:

our significant historical operating losses and uncertainties relating to our ability to generate positive cash flow and operating profits in the future;

difficulty in evaluating our future prospects based on our limited operating history and relatively new business model;

our ability to attract members, convert members into paying subscribers and retain our paying subscribers,

the highly competitive nature of our business;

our ability to keep pace with rapid technological change;

the strength of our existing brands and our ability to maintain and enhance those brands;

our ability to effectively manage our growth;

our dependence upon the telecommunications infrastructure and our networking hardware and software infrastructure;

risks related to our recent accounting restatements;

uncertainties relating to potential acquisitions of companies;

the volatility of the price of our equity securities;

the strain on our resources and management team of being a public company in the United States;

the ability of our principal shareholders to exercise significant influence over our company; and

other factors referenced in this annual report on Form 10-K and other reports.

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

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

ADDITIONAL INFORMATION

We are required to file annual, quarterly and special reports, proxy statements and other information with the SEC. You can read our SEC filings over the Internet at the SEC's Web site at <http://www.sec.gov>. You may also read and

copy any document we file with the SEC at its public reference facilities at 100 F Street, N.E. Washington, DC 20549. You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities. Our SEC filings are also available at the office of the American Stock Exchange. For further information on obtaining copies of our public filings at the American Stock Exchange, you should call (212) 306-1000.

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

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PART I

ITEM 1. BUSINESS

Our Business

We are a leading provider of online personals services in the United States and internationally. Our Web sites enable adults to meet online and participate in a community, become friends, date, form a long-term relationship or marry. We provide this opportunity through the many features on our Web sites, such as detailed profiles, onsite email centers, real-time chat rooms and instant messaging services. In 2005, Spark Networks averaged approximately 3.3 million monthly unique visitors to our Web sites in the United States, according to comScore Media Metrix, which ranked us as the third largest provider of online personals services in the United States. comScore Media Metrix defines total unique visitors as the estimated number of different individuals that visited any content of a Web site, a category, a channel, or an application during the reporting period. The number of total unique visitors to our Web sites as measured by comScore Media Metrix does not correspond to the number of members we have in any given period. Currently, our key Web sites are JDate.com and AmericanSingles.com. We operate several international Web sites and maintain operations in both the United States and Israel. Information regarding the geographical source of our revenues can be found in Note 12 to our Consolidated Financial Statements included in this annual report.

Membership on our sites is free and allows a registered user to post a personal profile and to access our searchable database of member profiles. The ability to initiate most communication with other members requires the payment of a monthly subscription fee, which represents our primary source of revenue. We also offer discounted subscription rates for members who subscribe for longer periods, ranging from three to twelve months. Following their initial terms, subscriptions on our Web sites renew automatically for subsequent one-month periods until paying subscribers terminate them.

For the year ended December 31, 2005, we had approximately 220,000 average paying subscribers, representing a decrease of 2.7% from 2004. Our JDate and AmericanSingles segments had approximately 70,500 and 105,300 average paying subscribers for the year ended December 31, 2005, an increase of 1% and a decrease of 20.5%, respectively, compared to 2004.

Our Industry

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

Our Competitive Strengths

Strength of JDate Brand. We believe that JDate's strong brand recognition in the Jewish community is a valuable asset. An analysis of comScore Media Metrix data, for the twelve months ended December 31, 2005, reveals that JDate.com experienced more average daily visitors and more page views than any other religious online personals service, and that JDate.com is the most popular religion-focused online personals service in the United States. We believe the strength of the JDate brand will continue to allow us to market to the Jewish community profitably while maintaining a high penetration rate. Because of the strength of the JDate brand, we are not required to spend as much on marketing to drive a member to JDate as we are our other Web sites, and as is typical of other Web sites in the industry.

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Web Site Functionality. We continually evaluate the functionality of our Web sites to improve our members' online personals experience. Many of the features that we offer, such as onsite email, real-time chat rooms and instant messaging, increase the probability of communication between our members, which we believe increases the number and percentage of members who become paying subscribers. We believe those types of functionality drive return visits to our Web sites and help us retain paying subscribers who might otherwise consider switching to our competitors' Web sites.

Customer Service Focus. We believe that our customer service focus offers us a competitive advantage and differentiates us from our major competitors. Our multi-lingual call center is staffed 24 hours a day, 7 days a week with customer service representatives. These representatives help members with a range of assistance, such as matters relating to completing personal profiles and choosing photos for their profiles, and answering questions about billing and technical issues. We believe that the quality of our customer service increases member satisfaction which, in turn, also increases the number and percentage of members that become and remain paying subscribers.

Our Online Personals Services

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

Our Web Sites. We believe we are a unique company in the online personals industry because, in addition to servicing mass markets, we also operate Web sites targeted at selected vertical affinity markets. We currently offer Web sites in English and Hebrew. Our key Web sites are as follows:

JDate.com. JDate was our first Web site and is dedicated to the Jewish community and culture, and those who are seeking to be part of it. An analysis of comScore Media Metrix data for the twelve months ended December 31, 2005, revealed that JDate.com experienced more average daily visitors and more page views than any other religious online personals service, and that JDate.com is the most popular religion-focused online personals service in the United States. JDate members are primarily concentrated in the New York, Los Angeles, Miami and Chicago metropolitan areas. The current fee for a one-month subscription on JDate is \$34.95.

AmericanSingles.com. AmericanSingles is our mainstream U.S. online personals community, targeted at an audience of singles between the ages of 25 and 49. The Web site caters to singles of all races, ethnicities and interests. AmericanSingles members are primarily concentrated in major metropolitan areas across the United States. The current fee for a one-month subscription on AmericanSingles is \$29.99.

Other Web sites.

<u>Web site</u>	<u>Target Markets</u>
AdventistSinglesConnection.com*	Adventist singles
AsianSinglesConnection.com*	Asian singles
BBWPersonalsPlus.com*	Big beautiful women, big handsome men and their admirers
BlackSinglesConnection.com*	African American singles
CanadianPersonals.net*	Canadian singles
CatholicMingle.com*	Catholic singles

ChristianMingle.com*

Christian singles

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<u>Web site</u>	<u>Target Markets</u>
CollegeLuv.com	College singles
Cupid.co.il	Jewish singles (Israel only)
Date.ca	Canadian singles
DeafSinglesConnection.com*	Deaf singles
GreekSinglesConnection.com*	Greek singles
IndianMatrimonialNetwork.com*	Indian singles
InterracialSingles.net*	Interracial singles
ItalianSinglesConnection.com*	Italian singles
JDate.co.il	Jewish singles (Israel only)
JewishMingle.com*	Jewish singles
LatinSinglesConnection.com*	Hispanic/Latin singles
LDSMingle.com*	Mormon singles
Date.co.uk	UK singles
MilitarySinglesConnection.com*	Military singles
PrimeSingles.net*	Mature singles
SingleParentsMingle.com*	Single parents
UKSinglesConnection.com*	UK singles

*Acquired through our acquisition of MingleMatch, Inc.

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

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

Hot Lists and Favorites. Among the most popular features on our Web sites, Hot Lists enable paying subscribers to see who's interested in them and to save those favorite members that they are interested in. Lists include (1) who has viewed your profile, (2) your favorites and (3) who has emailed you. Paying subscribers can group their favorites into customized folders and add their own notes, including details included in a member's profile.

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

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

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

Travel and Events. As a complement to our online services, we offer travel opportunities and other promotional events which allow individuals to meet in a more personal environment. Our travel and event programs are typically trips, dinners or other mixer events designed to facilitate social interaction. Less than 2% of our revenues for the year

ended December 31, 2005 were generated from travel and events.

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Business Strategy

We intend to grow our subscription-based revenue by driving additional traffic to our Web sites, through integrated and targeted marketing and cross-promotion into vertical affinity markets such as those acquired in the MingleMatch, Inc. acquisition. In addition, by providing strong customer service and improved features and functionality on our Web sites, we intend to provide more reasons for visitors to our Web sites to become and remain subscribers.

Drive Traffic. We believe there are significant opportunities to drive additional traffic to our Web sites and identify new markets, where we can leverage our existing infrastructure to increase subscriptions.

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

Cross-Promote Into Vertical Affinity Markets. Our large base of members provides us with a significant amount of consumer data to evaluate cross-promotion opportunities for growth into vertical affinity markets such as those acquired in the MingleMatch acquisition. We are able to analyze different groups of members by key metrics such as total potential subscribers and average revenue per paying subscriber and identify those targeted groups that may prefer a service dedicated to their particular affinity groups. We intend to target and cross-promote into vertical affinity markets that we believe are receptive to paid online personals and are large enough to attain a critical mass of members and paying subscribers.

Increase Subscription Rates. We had approximately 220,000 average paying subscribers for the year ended December 31, 2005. We believe that a significant growth opportunity lies in our ability to increase the number of visitors to our Web sites who become paying subscribers.

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

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

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

Customer Service

Our customer support and service function operates 24 hours a day, 7 days a week. As of December 31, 2005, we employed 42 customer service representatives at our Beverly Hills, California facility, 19 representatives in Provo, Utah and 13 customer service representatives at our facility in Israel. Our team of customer service representatives helps members with matters ranging from completing personal essays and choosing photos for their profiles to answering questions about billing and technical issues. Customer service representatives receive ongoing training in

an effort to better personalize the experience for visitors, members and

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paying subscribers that call in and to capitalize on upselling opportunities. On average, our customer service center receives approximately 1,700 phone calls and 5,000 emails per day, and our average wait time for phone calls and response time for emails are approximately three minutes and four hours, respectively.

Marketing

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

In addition to our online marketing efforts, we supplement our marketing by employing a variety of offline marketing activities. These primarily consist of print and outdoor advertising, public relations, event sponsorship and promotional alliances. We believe that more targeted marketing messages, delivered through an array of available marketing channels, will improve consumer awareness of our brands, drive more traffic to our Web sites and, therefore, increase the numbers of our members and paying subscribers. Specifically for JDate, we increased offline marketing spending. Such marketing initiatives are targeted at brand building and name recognition.

Technology

Our software development team consisted of 20 employees as of December 31, 2005, who are focused on expanding and improving the features and functionality of our Web sites. Since feature and functionality development is an important element of our strategy, we plan to expand that team. In addition to our development team, an additional 20 employees monitor and maintain our software and hardware infrastructure.

Our network infrastructure and operations are designed to deliver high levels of availability, performance, security and scalability in a cost-effective manner. The majority of our software architecture is based on standard modular Microsoft technology, which we believe facilitates the addition of new Web sites and features.

We recently completed a re-architecture of our primary system based on distributed Service Oriented Architecture principles using the Microsoft.Net platform. This re-architecture included changes to our server and network configurations, database schemas and deployment, web presentation methodologies and introduced a variety of new application services. We believe that this new architecture will enable us to more rapidly develop new capabilities and enhance our ability to scale our Web sites.

Our primary email system runs on dedicated appliances, with each server capable of sending approximately 2 million messages per hour. In addition to our email servers, we operate other Web and database servers, which are co-located at a data center facility in El Segundo, California that is operated by a third party. We are currently increasing redundant hardware and software systems in order to better support our services.

Intellectual Property

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

Spark Networks, JDate and AmericanSingles are some of our trademarks, whether registered or not, in the United States and several other countries. AmericanSingles and JDate are registered trademarks in the United States. JDate is also a registered trademark in the EU, Australia,

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Israel and Canada. Spark Networks is a registered trademark in the United States and EU. Our rights to these registered trademarks are perpetual as long as we use them and renew them periodically. We also have a number of other registered and unregistered trademarks. In addition, we hold a United States patent to *Click!*, which lasts until January 24, 2017, that pertains to an automated process for confidentially determining whether people feel mutual attraction or have mutual interests. *Click!* is important to our business in that it is a method and apparatus for detection of reciprocal interests or feelings and subsequent notification of such results. The patent describes the method and apparatus for the identification of a person's level of attraction and the subsequent notification when the feeling or attraction is mutual.

Competition

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

Employees

As of December 31, 2005, we had 193 full-time employees. We are not subject to any collective bargaining agreements and we believe that our relationship with our employees is good.

ITEM 1A. RISK FACTORS

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

Risks Related To Our Business

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

We have historically generated significant operating losses. As of December 31, 2005, we had an accumulated deficit of approximately \$45.1 million. We had net loss of approximately \$1.4 million for the year ended December 31, 2005 and a loss of \$11.6 million for the year ended December 31, 2004. We also had negative operating cash flow in 2004. We expect that our operating expenses will continue to increase during the next several years as a result of the promotion of our services, the hiring of additional key personnel, the expansion of our operations, including the launch of new Web sites, and entering into acquisitions, strategic alliances and joint ventures. If our revenues do not grow at a substantially faster rate than these expected increases in our expenses or if our operating expenses are higher than we anticipate, we may not be profitable and we may incur additional losses, which could be significant.

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

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

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business and prospects in light of the risks and difficulties we will encounter as an early-stage company in a new and rapidly evolving market. Our performance will depend on the continued acceptance and evolution of online personal services and other factors addressed herein. We may not be able to effectively assess or address the evolving risks and difficulties present in the market, which could threaten our capacity to continue operations successfully in the future.

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

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

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

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

In general, the costs of online advertising have recently increased substantially and we expect those costs to continue to increase as long as the demand for online advertising remains robust. If we are not able to reduce our other operating costs, increase our paying subscriber base or increase revenue per paying subscriber to offset these anticipated increases, our profitability will be adversely affected.

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

We expect competition in the online personals business to continue to increase because there are no substantial barriers to entry. For example, an article in the USA Today stated that there are signs of fierce competition among online personals sites, and that an Internet tracking firm found that the number of online personals sites it monitors had reached 836 in February 2005, up from 611 in January 2004. We believe that our ability to compete depends upon many factors both within and beyond our control, including the following:

- the size and diversity of our member and paying subscriber bases;

- the timing and market acceptance of our products and services, including the developments and enhancements to those products and services relative to those offered by our competitors;

- customer service and support efforts;

- selling and marketing efforts; and

- our brand strength in the marketplace relative to our competitors.

We compete with traditional personals services, as well as newspapers, magazines and other traditional media companies that provide personals services. We compete with a number of large and small companies, including Internet portals and specialty-focused media companies that provide online and offline products and services to the markets we serve. Our principal online personals services competitors include Yahoo! Personals, Match.com, a wholly-owned subsidiary of InterActiveCorp, and eHarmony, all of which operate primarily in North America. In addition, we face competition from social networking Web sites such as MySpace and Friendster. Many of our current and potential competitors have longer operating histories, significantly greater financial, technical, marketing and other resources and larger customer bases than we do. These factors may allow our competitors to respond more quickly than we can to new or emerging technologies and changes in customer requirements. These

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competitors may engage in more extensive research and development efforts, undertake more far-reaching marketing campaigns and adopt more aggressive pricing policies which may allow them to build larger member and paying subscriber bases than we have. Our competitors may develop products or services that are equal or superior to our products and services or that achieve greater market acceptance than our products and services. These activities could attract members and paying subscribers away from our Web sites and reduce our market share.

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

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

One of our strategies is to expand into new vertical affinity markets to increase our revenue base. We view vertical affinity markets as identifiable groups of people who share common interests and the desire to meet companions or dates with similar interests, backgrounds or traits. Our planned expansion into such vertical affinity markets will occupy our management's time and attention and will require us to invest significant capital resources. The results of our expansion efforts into new vertical affinity markets are unpredictable, and there is no guarantee that our efforts will have a positive effect on our revenue base. We face many risks associated with our planned expansion into new vertical affinity markets, including but not limited to the following:

- competition from pre-existing competitors with significantly stronger brand recognition in the markets we enter;

- our improper evaluations of the potential of such markets;

- diversion of capital and other valuable resources away from our core business and other

- opportunities that are potentially more profitable; and

- weakening our current brands by over expansion into too many new markets.

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

We operate in a market characterized by rapidly changing technologies, evolving industry standards, frequent new product and service announcements, enhancements and changing customer demands. Accordingly, our performance will depend on our ability to adapt to rapidly changing technologies and industry standards, and our ability to continually improve the speed, performance, features, ease of use and reliability of our services in response to both evolving demands of the marketplace and competitive service and product offerings. There have been occasions when we have not been as responsive as many of our competitors in adapting our services to changing industry standards and the needs of our members and paying subscribers. Our industry has been subject to constant innovation and competition. Historically, new features may be introduced by one competitor, and if they are perceived as attractive to users, they are often copied later by others. Over the last few years, such new feature introductions in the industry have included instant messaging, message boards, ecards, personality profiles, and mobile content delivery. We are currently unable to deliver mobile features until completion of our new system architecture. Introducing new technologies into our systems involves numerous technical challenges, substantial amounts of capital and personnel resources and often takes many months to complete. We intend to continue to devote efforts and funds toward the development of additional technologies and services. For example, in 2004 and 2005 we introduced a number of new Web sites and features, and we anticipate the introduction of additional Web sites and features in 2006 and 2007. We may not be able to effectively integrate new technologies into our Web sites on a timely basis or at all, which may

degrade the responsiveness and speed of our Web sites. Such technologies, even if integrated, may not function as expected.

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

We believe that establishing and maintaining our brands is critical to our efforts to attract and expand our member and paying subscriber bases. We believe that the importance of brand recognition will continue to increase, given the growing number of Internet sites and the low barriers to entry for companies offering online personals services. For example, an article in the USA Today stated that there are signs of fierce competition among online personals sites, and that an Internet tracking firm found that the number of online personals sites it monitors had reached 836 in February 2005, up from 611 in January 2004. To attract and retain members and paying subscribers, and to promote and maintain our brands in response to competitive pressures, we intend to substantially increase our financial commitment to creating and maintaining distinct brand loyalty among these groups. If visitors, members and paying subscribers to our Web sites and our affiliate and distribution associates do not perceive our existing services to be of high quality, or if we introduce new services or enter into new business ventures that are not favorably received by such parties, the value of our brands could be diluted, thereby decreasing the attractiveness of our Web sites to such parties. In addition, we changed our corporate name in January 2005 from MatchNet plc to Spark Networks plc, however, we did not change the names of our Web sites or brand names. Our adoption of a new corporate name may prevent us from taking advantage of goodwill that potential and existing customers may have associated with our old corporate name. As a result, our results of operations may be adversely affected by decreased brand recognition.

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

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

As of December 31, 2005, assuming every eligible optionee were to accept a rescission offer, we estimate the total cost to us to complete the rescission would be approximately \$1.9 million including statutory interest at 7% per annum. These amounts reflect the costs of offering to rescind the issuance of the outstanding options by paying an amount equal to 20% of the aggregate exercise price for the entire option.

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

As of December 31, 2005, assuming every eligible person that continues to hold the securities issued upon exercise of options granted under the 2000 Option Scheme were to accept a rescission offer, we estimate the total cost to us to complete the rescission would be approximately \$6.1 million including statutory interest at 7% per annum, accrued since the date of exercise of the options. These amounts are calculated by reference to the acquisition price of the Option Shares.

A holder could argue that this process does not represent an adequate remedy for issuance of an option and securities issued upon exercise of an option in violation of California state or federal securities laws and, if a court were to

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

For the purposes of English company law, a rescission offer in respect of our Option Shares would take the form of a purchase by our company of the relevant Option Shares. The Companies Act 1985 (the Companies Act) provides that we may only purchase our own shares using our distributable profits (as defined by the Companies Act), also known as distributable reserves (the Distributable Reserves), or the proceeds from the issuance of new shares for that purpose. When we issue shares at a value which represents a premium over their nominal value, we are required by the Companies Act to transfer the premium (subject to certain limited exceptions) to a share premium account. Under the Companies Act, our ability to utilize our share premium account is very limited and does not include the payment of dividends. However, in accordance with a procedure set out in the Companies Act, we have obtained approval from our shareholders and from the High Court of Justice in England and Wales (the Court) to reduce our share premium account by US\$44,000,000 with effect from December 8, 2005 (the Effective Date) in order to reduce or eliminate the deficit on our profit and loss account, which had arisen as a result of previous accumulated losses. This will enable profits, if any, arising after December 31, 2005 to give rise to Distributable Reserves, which we could use to purchase our own shares pursuant to a rescission offer. In connection with the approval from the Court, we have given an undertaking to the Court for the protection of our creditors, which requires us to transfer to a non-distributable reserve (the Special Reserve) the amount (if any) by which the deficit on our profit and loss account at December 31, 2005 falls short of the amount of the reduction (being US\$44,000,000), and any profits made by us or any of our subsidiaries prior to December 31, 2005, until our non-consenting creditors at the Effective Date (the Non-Consenting Creditors) have been paid off. In other words, if there is a surplus on our profit and loss account after application of the \$44.0 million from the share premium reduction and any additional profits made by us prior to December 31, 2005 (the Special Reserve Surplus), then we would not be permitted to use the Special Reserve Surplus to purchase our own shares until all Non-Consenting Creditors are paid. However, we do not currently expect that any sums will be required to be transferred to the Special Reserve since we do not anticipate that there will be a surplus on our profit and loss account after application of the share premium reduction and any profits made before December 31, 2005, although this will need to be confirmed when we prepare our audited UK GAAP profit and loss account and balance sheet for the year ended December 31, 2005.

Although we believe we have substantially reduced our accumulated profit and loss account deficit pursuant to the Companies Act, we are not permitted to purchase any of our own shares until we have sufficient Distributable Reserves in order to fund such purchases of our own shares or sufficient proceeds of a new issuance of shares made for the purposes of such purchases of our own shares. As of December 31, 2005, if every eligible person holding Option Shares were to accept the rescission offer, we estimate that the amount we would need in Distributable Reserves is approximately \$6.1 million. After application of the share premium reduction to the accumulated profit and loss account deficit, we anticipate that the deficit will be substantially reduced; however, we will not have any Distributable Reserves, which we will accumulate to the extent that we make any distributable profits in the future. We do not intend to make a rescission offer until we have the Distributable Reserves required to make a rescission offer of the Option Shares.

The undertaking to the Court also prevents us from making any distribution to shareholders, or redeeming or purchasing our own shares, until we have obtained approval at a shareholders' general meeting of our audited UK GAAP balance sheet for the year ended December 31, 2005. It is likely that our UK GAAP balance sheet for the year ended December 31, 2005 will be ready for approval by shareholders on or about May 31, 2006. The share premium reduction will only be reflected on our UK GAAP balance sheet for the purposes of UK law. It will not be reflected on our US GAAP balance sheet.

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Any purchase of the Option Shares pursuant to a rescission offer would not only need to be made out of Distributable Reserves, but would also require shareholder approval given in accordance with the requirements of the Companies Act. Such approval must be given by resolution passed with a majority of at least 75% of the votes cast on the resolution (excluding votes carried by the Option Shares proposed to be purchased), having made a copy of the contract for the purchase of the Option Shares available for inspection both at our registered office for at least 15 days prior to the date of the meeting to approve the purchase and at the meeting itself. Once a purchase has been completed, we would be subject to further disclosure obligations in relation to information about the purchase.

We do not intend to seek shareholder approval for a purchase of Option Shares until we have made a rescission offer which has been accepted by any one or more shareholders and it has become necessary to seek such approval.

In summary, in order to effectuate a rescission offer and repurchase any of our own shares upon any acceptances of the rescission offer, we must satisfy the following conditions: (1) obtain shareholder approval of our audited UK GAAP balance sheet for the year ended December 31, 2005; (2) obtain additional shareholder approval, as further discussed above, of any acceptances of the rescission offer to repurchase shares; and (3) have sufficient Distributable Reserves to repurchase shares subject to the rescission offer.

If we do not obtain the requisite shareholder approval of acceptances to a rescission offer or if we continue to accumulate a deficit on our profit and loss account and we do not issue new shares for additional funds for a rescission offer, then we will not be able to effectuate a rescission offer.

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

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

Our performance is largely dependent on the talents and efforts of highly skilled individuals. We have recently recruited many of our directors, executive officers and other key management talent, some of which have limited or no experience in the online personals industry. For example, David E. Siminoff, our President and Chief Executive Officer, joined us in August 2004 and each of our Chief Financial Officer, Chief Operating Officer and General Counsel, and Chief Technology Officer joined us in October 2004. Because members of our executive management have only worked together as a team for a limited time, there are inherent risks in the management of our company with respect to decision-making, business direction, product development and strategic relationships. In the event that the members of our executive management team are unable to work well together or agree on operating principles, business direction or business transactions or are unable to provide cohesive leadership, our business could be harmed and one or more of those individuals may discontinue their service to our company, and we would be forced to find a suitable replacement. The loss of any of our management or key personnel could seriously harm our business.

Furthermore, we have recently experienced significant turnover on our board of directors. We currently have seven members serving on our board of directors. Since October 2004, we have had two directors resign from our board of directors and five directors join our board of directors. Alon Carmel, one of our company's co-founders and co-chairmen, resigned from his position in February 2005 to pursue other entrepreneurial and philanthropic interests. In August 2004, we initiated a cost reduction program and terminated the employment of 40 full-time and temporary employees, and, as a result, our future recruiting efforts may become more difficult. We may also encounter difficulties in recruiting personnel as we become a more mature company in a competitive industry. Competition in our industry for personnel is intense, and we are aware that our competitors have directly targeted our employees. We do not have non-competition agreements with most employees and, even in cases where we do, these agreements are of limited enforceability in California. We also do not maintain any key-person life insurance policies on our executives. The incentives to attract, retain and motivate employees provided by our option grants or by future arrangements, such as cash bonuses, may not be as effective as they have been in the past. If we do not

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succeed in attracting necessary personnel or retaining and motivating existing personnel, we may be unable to grow effectively.

Our inability to effectively manage our growth could have a materially adverse effect on our profitability.

We have experienced rapid growth since inception. The growth and expansion of our business and service offerings places a continuous significant strain on our management, operational and financial resources. We are required to manage multiple relations with various strategic associates, technology licensors, members, paying subscribers and other third parties. In the event of further growth of our operations or in the number of our third-party relationships, our computer systems or procedures may not be adequate to support our operations and our management may not be able to manage such growth effectively. To effectively manage our growth, we must continue to implement and improve our operational, financial and management information systems and to expand, train and manage our employee base. If we fail to do so, our management, operational and financial resources could be overstrained and adversely impacted.

We expect our growth rates to decline and our operating margins could deteriorate.

We believe our revenue growth rate will decline as our net revenues increase to higher levels and as the growth of the online personals industry begins to slow. We have seen a decline in our growth rates during the latter stages of 2004 and first half of 2005. A February 2005 report by Jupiter Research forecasts the online personals industry will experience single digit growth in 2005 as compared to 77% growth in 2003. It is possible that our operating margins will deteriorate if revenue growth does not exceed planned increases in expenditures for all aspects of our business in an increasingly competitive environment, including sales and marketing, general and administrative and technical operations expenses.

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

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

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

In addition, we do not currently have adequate disaster recovery systems in place, which means in the event of any catastrophic failure involving our Web sites, we may be unable to serve our Web traffic for a significant period of time. Our servers primarily operate from only a single site in Southern California and the absence of a backup site

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could exacerbate this disruption. Any system failure, including network, software or hardware failure, that causes an interruption in the delivery of our Web sites and services or a decrease in responsiveness of our services would result in reduced visitor traffic, reduced revenue and would adversely affect our reputation and brands.

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

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

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

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

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

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports, effectively prevent fraud and operate as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We have, in the past, discovered and may, in the future, discover areas of our internal controls over financial reporting that need improvement. For example, during our audit of 2003 results, our external auditors brought to our attention a need to restate 2001 and 2002 results and also noted, in a letter to management, certain conditions involving internal controls and operations, none of which were a material weakness. Furthermore, in 1994, a civil action was filed in Israeli district court (the Action) involving Videomatrix Industries, LTD (Videomatrix), a company unrelated to Spark Networks except of which our former Co-chairman and current Chairman were officers. In that Action, our former Co-chairman was a respondent, the Israeli equivalent of a defendant, and our current Chairman was a formal respondent, but not a defendant. The Action was initiated by a venture capital lender to, and investor in, Videomatrix. The Israeli court appointed an investigator to make factual findings. The investigator noted that there were inaccurate records and/or entries in corporate books, incomplete disclosures and/or inaccurate representations in a prospectus, questionable documents, and undisclosed related party transactions, involving Videomatrix. Thereafter, the court issued an order providing for a four month moratorium on

litigation to permit Videomatrix, its audit committee, and its auditors to conduct an examination and form conclusions. Our Chairman and former Co-chairman purchased the entire

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ownership interest of the venture capital lender in Videomatrix during the moratorium provided for in the court order and no further action was taken by the venture capital lender in connection with this matter.

As a U.S. public company, we are subject to the reporting requirements of the Sarbanes-Oxley Act of 2002. We will be required to annually assess and report on our internal controls over financial reporting. If we are unable to adequately establish or improve our internal controls over financial reporting, we may report that our internal controls are ineffective and our external auditors will not be able to issue an unqualified opinion on the effectiveness of our internal controls. Ineffective internal controls over financial reporting could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our securities or could affect our ability to access the capital markets and which could result in regulatory proceedings against us by, among others, the U.S. Securities Exchange Commission.

We face risks related to our recent accounting restatements, which could result in costly litigation or regulatory proceedings against us.

Our ordinary shares in the form of GDSs trade on the Frankfurt Stock Exchange in Germany. Pursuant to the laws governing this exchange, we have been publicly reporting our quarterly and annual operating results. On April 28, 2004, we publicly announced that we had discovered accounting inaccuracies in previously reported financial statements. As a result, following consultation with our new auditors, we restated our financial statements for the nine months ended September 30, 2003 and for each of the years ended December 31, 2001 and 2002 to correct inappropriate accounting entries. The restatements primarily related to the timing of recognition of deferred revenue and the capitalization of bounty costs, which are the amounts paid to online marketers to acquire members. The restatements are in accordance with United States generally accepted accounting principles and pertain primarily to timing matters and had no impact on cash flow from operations or our ongoing operations. The impact on net loss for 2001 and 2002 was an increase of \$1.5 million and \$1.0 million, respectively.

The restatement of the financial statements may lead to litigation claims and/or regulatory proceedings against us. The defense of any such claims or proceedings may cause the diversion of management's attention and resources, and we may be required to pay damages if any such claims or proceedings are not resolved in our favor. Any litigation or regulatory proceeding, even if resolved in our favor, could cause us to incur significant legal and other expenses. Moreover, we may be the subject of negative publicity focusing on the financial statement inaccuracies and resulting restatement. The occurrence of any of the foregoing could divert our resources, harm our reputation and cause the price of our securities to decline.

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

In May 2005, we acquired MingleMatch, Inc., and we plan, during the next few years, to further extend and develop our presence, both within the United States and internationally, partially through acquisitions of entities offering online personals services and related businesses. We have limited experience acquiring companies and the companies we have acquired have been small. We have evaluated, and continue to evaluate, a wide array of potential strategic transactions. From time to time, we may engage in discussions regarding potential acquisitions, some of which may divert significant resources away from our daily operations. In addition, the process of integrating an acquired company, business or technology is risky and may create unforeseen operating difficulties and expenditures. For example, we have been engaged in significant litigation in the past, but which has since settled, with respect to our acquisition of SocialNet, Inc. in 2001. Some areas where we may face risks include:

the need to implement or