SPARK NETWORKS PLC
Form 10-Q
May 10, 2007
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2007**

**OR**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from ______ to ______**

**Commission file number: 000-51195**

# SPARK NETWORKS PLC

***(Exact name of registrant as specified in its charter)***

| | |
|---|---|
| **ENGLAND AND WALES** | **98-0200628** |
| ***(State or other jurisdiction of incorporation or organization)*** | ***(I.R.S. Employer Identification No.)*** |
| **8383 Wilshire Boulevard, Suite 800, Beverly** | **90211** |

**Hills, California**
*(Address of principal executive offices)* *(Zip Code)*

**(323) 836-3000**

*(Registrant s telephone number, including area code)*

**N/A**

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

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

Indicate by check mark whether the registrant 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.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

The registrant had 30,742,808 outstanding ordinary shares, par value £0.01 per share, as of May 9, 2007.

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**SP ARK NETWORKS, PLC**

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For the period ended March 31, 2007

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ITEM 1. FINANCIAL STATEMENTS

**SPARK NETWORKS PLC**

**CONSOLIDATED BALANCE SHEETS**

**(in thousands, except share data)**

| | March 31, 2007 (unaudited) | December 31, 2006 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 19,492 | $ 20,412 |
| Marketable securities | 197 | 196 |
| Restricted cash | 2,013 | 2,070 |
| Accounts receivable, net of allowance of $50 and $0 for March 31, 2007 and December 31, 2006 | 1,029 | 1,200 |
| Deferred tax asset current portion | 632 | 219 |
| Prepaid expenses and other | 1,444 | 1,509 |
| Total current assets | 24,807 | 25,606 |
| Property and equipment, net | 1,816 | 2,306 |
| Goodwill, net | 17,917 | 19,236 |
| Intangible assets, net | 5,826 | 4,406 |
| Deposits and other assets | 56 | 72 |
| Total assets | $ 50,422 | $ 51,626 |
| **Liabilities and Shareholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,692 | $ 1,487 |
| Accrued liabilities | 4,621 | 4,985 |
| Deferred revenue | 4,320 | 4,051 |
| Notes payable current portion | 1,491 | 1,314 |
| Current portion of obligations under capital leases | | 43 |
| Total current liabilities | 12,124 | 11,880 |
| Deferred tax liabilities | 1,826 | 1,782 |
| Obligations under capital leases | | 59 |
| Total liabilities | 13,950 | 13,721 |
| Shares subject to rescission (Note 6) | 8,309 | 8,079 |
| Commitments and contingencies (Note 8) | | |
| Shareholders equity: | | |
| Authorized capital £800,000 divided into 80,000,000 ordinary shares of 1p each; issued and outstanding 30,761,855 shares as of March 31, 2007 and 30,941,465 shares as of December 31, 2006, at a stated value of: | 442 | 517 |
| Additional paid-in-capital | 67,824 | 67,571 |
| Accumulated other comprehensive income | 375 | 248 |
| Accumulated deficit | (40,478) | (38,510) |
| Total shareholders equity | 28,163 | 29,826 |
| Total liabilities and shareholders equity | $ 50,422 | $ 51,626 |

**See accompanying notes.**

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**SPARK NETWORKS PLC**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(unaudited, in thousands, except per share data)**

| | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| Net revenues | $ 16,820 | $ 16,805 |
| Direct marketing expenses | 6,757 | 5,657 |
| Contribution margin | 10,063 | 11,148 |
| Operating expenses: | | |
| Indirect marketing (including share-based compensation of $10 and $13) | 327 | 366 |
| Customer service (including share-based compensation of $19 and $23) | 929 | 908 |
| Technical operations (including share-based compensation of $179 and $174) | 1,424 | 2,230 |
| Product development (including share-based compensation of $88 and $118) | 806 | 845 |
| General and administrative (including share-based compensation of $1,763 and $1,028) | 6,585 | 5,632 |
| Amortization of intangible assets other than goodwill | 344 | 239 |
| Impairment of goodwill | 1,894 | |
| Total operating expenses | 12,309 | 10,220 |
| Operating (loss) income | (2,246) | 928 |
| Interest (income), loss and other expenses, net | (205) | 39 |
| (Loss) income before income taxes | (2,041) | 889 |
| (Benefit) provision for income taxes | (73) | 179 |
| Net (loss) income | $ (1,968) | $ 710 |
| Net (loss) income per share basic | $ (0.06) | $ 0.02 |
| Net (loss) income per share diluted | $ (0.06) | $ 0.02 |
| Weighted average shares outstanding basic | 30,868 | 30,266 |
| Weighted average shares outstanding diluted | 30,868 | 31,258 |

**See accompanying notes.**

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**SPARK NETWORKS PLC**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(unaudited, in thousands)**

| | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ (1,968) | $ 710 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 891 | 1,056 |
| Impairment of goodwill | 1,894 | |
| Share-based compensation | 2,059 | 1,371 |
| Deferred tax liability | (329) | 55 |
| Imputed interest on notes payable | | 52 |
| Impairment of employee loan | | 82 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 171 | 457 |
| Restricted cash | 57 | (913) |
| Prepaid expenses and other assets | 88 | 6 |
| Accounts payable and accrued liabilities | (147) | 752 |
| Deferred revenue | 269 | 685 |
| Net cash provided by operating activities | 2,985 | 4,313 |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | (81) | (293) |
| Purchases of intangible assets | (3) | (300) |
| Cash paid in acquisition of business, net of cash acquired | (2,007) | |
| Sale of property and equipment | 31 | |
| Net cash used in investing activities | (2,060) | (593) |
| **Cash flows from financing activities:** | | |
| Proceeds from issuance of ordinary shares | 146 | 113 |
| Purchase of shares for retirement | (1,800) | |
| Principal payments of capital lease obligations | (102) | (4) |
| Principal payments of notes payable for acquisition | | (5,000) |
| Excess tax benefits from stock-based compensation | (4) | |
| Notes Payable | (85) | (285) |
| Net cash used in financing activities | (1,845) | (5,176) |
| Net (decrease) increase in cash | (920) | (1,456) |
| Cash and cash equivalents at beginning of period | 20,412 | 17,096 |
| Cash and cash equivalents at end of period | $ 19,492 | $ 15,640 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | $ 867 | $ 76 |
| Assets acquired through a capital lease | $ | $ 135 |

**See accompanying notes.**

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**SPARK NETWORKS PLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. The Company and Summary of Significant Accounting Policies**

***The Company***

Spark Networks plc (the Company ) is a public limited company incorporated under the laws of England and Wales. The Company has American Depositary Receipts which are traded on the American Stock Exchange and Global Depositary Receipts which are traded on the Frankfurt Stock Exchange. 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 websites and search and contact other individuals who have posted profiles.

Membership in 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 charges a subscription fee for one-, three-, five-, six- and twelve-, month subscriptions to members allowing them to initiate communication with other members and subscribers via the Company s email communications platform. 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 revenues and expenses using average rates of exchange for the period. The resulting gain or loss is included in accumulated other comprehensive income (loss) and is excluded from net income (loss).

***Interim Financial Information***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. Certain information and note disclosures normally included in the consolidated annual financial statements prepared in accordance with generally accepted accounting principles in the United States have been omitted from this interim report. In the opinion of the Company s management, the unaudited interim consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments (consisting of normal recurring accruals) necessary for the fair presentation of the Company s financial position, results of operations and cash flows as of and for the periods presented. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future period.

These interim financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

***Share-Based Compensation***

The Company accounts for shares issued to employees and directors in accordance with the provisions of SFAS 123 (R) which it adopted on July 1, 2005.

At March 31, 2007, the Company had two share-based employee compensation plans, which are described more fully in Note 6. Effective July 1, 2005, the Company adopted the fair value recognition provisions of Statement 123(R), using the

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modified- prospective transition method. Under that transition method, compensation cost recognized includes: (i) compensation cost for all share-based payments granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (ii) compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been restated.

Prior to its adoption of Statement 123(R), 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 its deferred tax assets in future tax returns. Statement 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The Company recognized a tax provision from deductions resulting from the exercise of share options in the first quarter of 2007 and classified the provision as a financing cash outflow on the cash flow statement.

The Company accounts for shares issued to non-employees in accordance with the provisions of SFAS No. 123(R) and EITF 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services* .

***Earnings Per Share***

The Company calculates net income (loss) per share in accordance with SFAS No. 128 Earnings per Share , which requires the presentation of both basic and diluted net income (loss) per share. Basic net income (loss) per share is computed by dividing net income (loss) available to ordinary shareholders by the weighted average number of ordinary shares outstanding. Diluted net loss per share includes the effect of potential shares outstanding, including dilutive share options and warrants, using the treasury stock method. Had the Company s net income been positive for the quarter ended March 31, 2007, the weighted average shares outstanding for the diluted earnings per share calculation would have been 31,085,834, using the treasury stock method as adjusted under SFAS 123 (R).

***Comprehensive Income (Loss)***

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

| | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| Net (loss) income | $ (1,968) | $ 710 |
| Changes in unrealized gains/losses in available for sale securities | 1 | 10 |
| Foreign currency translation adjustment | 126 | (94) |
| Total comprehensive (loss) income | $ (1,841) | $ 626 |

***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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

***New Accounting Standard***

The Company adopted the provisions of Financial Accounting Standards Board ( FASB ) Interpretation No. 48. Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 ( FIN 48 ) on January 1, 2007. FIN 48 provides that the tax effects from an uncertain tax position can be recognized 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. No impact on our financial statements was recorded as a result of our adoption of FIN 48.

The Company s US Federal tax returns have been audited by the IRS for tax year 2003.

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**2. Net Income (Loss) Per Share**

The Company calculates net income (loss) per share in accordance with SFAS No. 128 Earnings per Share , which requires the presentation of both basic and diluted net income (loss) per share. Basic net income (loss) per share is computed by dividing net income (loss) available to ordinary shareholders by the weighted average number of ordinary shares outstanding. Diluted net income (loss) per share includes the effect of potential shares outstanding, including dilutive share options and warrants, using the treasury stock method as prescribed by SFAS 123(R).

**3. Acquisitions of Businesses and Intangibles**

***Domain Names***

On March 24, 2006 the Company acquired certain domain names and trademarks for approximately $300,000. The Company expects the purchase of the domain names to allow for synergistic uses of existing databases. The domain names are assigned an infinite life and are subject to impairment testing under SFAS No. 142 Goodwill and Other Intangible Assets.

***HurryDate***

On February 1, 2007, the Company entered into an agreement to purchase the assets of HurryDate, a leading online personals and singles events company, for total consideration of $2.25 million, of which $2.0 million was paid up front in cash, and, subject to certain conditions in the purchase agreement, payment of an earn-out based upon the operating income of the HurryDate business for the period of April 1, 2007 to March 31, 2008. The purchase of HurryDate will expand the Company s offline presence and is intended to solidify its position as the only leading online personals provider to effectively marry the online and offline dating worlds. Of the $2.2 million of acquired intangible assets, $490,000 was preliminarily assigned to member databases and will be amortized over three years, $50,000 was preliminarily assigned to subscriber databases which will be amortized over five months, $800,000 was preliminarily assigned to developed software which will be amortized over five years, $360,000 was preliminarily assigned to domain names which are not subject to amortization, and $480,000 was preliminarily assigned to goodwill.

***LDSSingles***

On May 5, 2006 we completed the purchase of certain assets of LDSSingles Inc., a company that operates a religious online singles community, for total consideration of $2.3 million, of which $2.0 million was paid up front in cash and $300,000 will be paid in cash on the one year anniversary of the acquisition. The results of LDSSingles operations have been included in the consolidated financial statements since that date. The Company believes that its acquisition of LDSSingles will allow the Company to strengthen its market share related to the religious online singles niche. Of the $2.2 million of acquired intangible assets, $170,000 was assigned to member databases and will be amortized over five years, $140,000 was assigned to subscriber databases which was amortized over six months, $200,000 was assigned to developed software which will be amortized over two years, $250,000 was assigned to domain names which are not subject to amortization, and $1.4 million was assigned to goodwill.

***Playahead AB (formerly Duplo AB)***

On September 9, 2004, the Company acquired a 20% interest in Playahead (Duplo AB) for approximately $1.2 million including professional fees related to the transaction. Playahead AB owns and operates Playahead.com, a community site primarily focused on the Swedish market, whose members range in age primarily from 16-35. On October 19, 2006, the Company sold its 20% interest in PlayAhead (Duplo AB) for $1.4 million and recognized a gain of approximately $300,000.

***Impairment of Goodwill***

The Company recorded $1.9 million in impairment expense related to the impairment of the book carrying value of goodwill under SFAS 142 related to AmericanSingles.

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**4. Obligations Under Capital Leases**

In the first quarter of 2006, the Company entered into certain lease agreements for computer equipment and software under capital lease agreements effective through January 2009, providing for minimum lease payments in 2006. In March 2007, the Company paid $102,000 to relieve future capital lease obligations.

**5. Notes Payable**

In September 2004, the Company issued a promissory note in the amount of $1.7 million as a final settlement for a lawsuit. The note bears interest at the rate of 2.75% per year and is payable in installments on (i) September 15, 2005 in the amount of $400,000; (ii) September 15, 2006 in the amount of $400,000; and (iii) September 15, 2007 in the amount of $900,000.

In February 2007, the Company issued a promissory note in the amount of $250,000 in connection with the HurryDate acquisition. The note bears no interest and is payable in May of 2007.