FINAL TRANSCRIPT

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TREE - Q2 2010 Tree.com, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, everyone and welcome to the Tree.com second-quarter 2010 earnings conference call. Today's call is being recorded. At this time, I would like to turn the call over to Doug Lebda, Chairman and Chief Executive Officer. Please go ahead, sir.

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

Thanks, Operator and thank you to everyone for joining us today for Tree.com's Q2 2010 earnings conference call. First, a quick disclaimer. During this call, we may discuss Tree.com's plans, expectations, outlook or forecast for future performance. These forward-looking statements typically are preceded by words such as we expect, we believe, we anticipate, we are looking to or other similar statements. These forward-looking statements are subject to risks and uncertainties and Tree.com's actual results could differ materially from the views expressed today. Some of the risks we face have been set forth in our earnings release and in greater detail in our periodic reports filed with the SEC.

We will also discuss certain non-GAAP measures such as EBITDA. I refer you to today's press release for all the comparable GAAP measures, definitions, and full reconciliations of adjusted EBITDA and EBITDA to net income.

Overall, we had a good quarter. We posted our third consecutive quarter of positive adjusted EBITDA at $3.4 million, an improvement of $2.6 million over Q1. This improvement in the bottom line came in spite of a 5% decline in revenue quarter over quarter. The lower revenue versus last quarter was due primarily to fewer closings in matched loan requests on the lending exchange and seasonally fewer matched consumer requests in our non-mortgage verticals.

Looking year over year, both revenue and adjusted EBITDA were down, which was anticipated given the significant refinance activity in Q2 of 2009.

Before I turn the call over to Tamara, let me provide some highlights from our individual lines of businesses. At LendingTree Loans, we continued the strong bottom-line performance we have seen since early 2009, delivering another quarter of positive adjusted EBITDA. LTL had $4.6 million of adjusted EBITDA in the quarter, which was a $1.8 million improvement over Q1. This segment of our business continues to succeed in an extremely volatile mortgage market. In a quarter where transaction volumes from network lenders dropped quarter over quarter, the LendingTree Loans segment held steady with total funded loans 4% higher than the prior quarter.

On the marketing front, we continue to test and develop new ways to drive volume to our network of lenders, as well as directly to licensed loan officers at LendingTree Loans. We are increasingly encouraged by the success of the 800-number banner ad leads in addition to our short short form leads which is a form that captures limited consumer information like name, phone number and e-mail.

In newer development and marketing this quarter is the launch of our Weekly Mortgage Rate Pulse, which was launched in mid-June and provides a terrific benefit to the Company by increasing our already strong brand and making consumers aware of time-sensitive developments in the mortgage industry. Since this launch, we have seen a 78% increase in organic traffic to our mortgage rate page.

In the lending exchange, the average revenue generated from each loan request continues to grow, now at levels 85% greater than one year ago. This is admittedly comparing against a low base, but nonetheless the improvement over the last several quarters will enable us to spend more on marketing in the future.

In our non-mortgage verticals, we continue to make progress against our strategy of diversification. Verticals like education, home services and insurance are gaining traction and generating revenue in businesses that were nonexistent for us a year ago.

While total matches in non-mortgage services dropped quarter over quarter, this is due in part to typical Q1 to 2Q seasonality in the education space. Still, we generated nearly 150,000 non-mortgage consumer matches in the quarter, accounting for over 50% of our total exchange-generated leads. Also, as I mentioned last quarter, we continue to make progress in the launch of the new Tree.com website and anticipate the full site launch later this summer.

In the Real Estate segment, this business continues to operate reasonably well in a difficult market. Closed transactions were up 23% over Q1, which was an anticipated seasonal increase. We also experienced the stabilization of home prices in the quarter after two consecutive quarterly declines and all in, the Real Estate segment posted breakeven adjusted EBITDA in the quarter. And now, let me turn it over to Tamara to take you through the detailed financial results.

Tamara Kotronis - *Tree.com, Inc. - SVP, Financial Planning & Analysis & IR*

Thanks, Doug and good morning to all on the line today. As you see in our release, we reported $3.4 million of positive adjusted EBITDA, $2.6 million better than the prior quarter on revenue that was approximately 5% below Q1. On a GAAP basis, our net loss was $800,000, or $0.07 per share, which was an improvement over the prior quarter net loss of $6.1 million, or $0.56 per share.

Moving into the segments, as Doug mentioned a moment ago, LTL adjusted EBITDA was $4.6 million in the quarter, which is approximately $1.8 million greater than Q1. Revenue improved $900,000, or 4% over Q1. Revenue from origination in sales loans was up slightly over the prior quarter as closed loan transactions increased 4%.

We realized a 5% increase in margin in this record low interest rate environment, but also increased the provision for loan losses as a result of extending the period of time in which we expect to have exposure from 60 months to 72 months.

In the quarter, we increased our provision by $3 million, which is double the amount recognized in Q1. During the second quarter, LTL experienced a late-quarter surge in lead volume, which resulted in a 13% increase in total leads over Q1. However, because it was largely the result of the drop in interest rates, the additional volume quarter-over-quarter did not come with an increase in marketing expense. As such, we saw a 12% quarter-over-quarter improvement in marketing costs per acquired lead.

Per our recent filings, LendingTree Loans renewed its warehouse line agreement with Bank of America running through June 29, 2011. The renewal includes the reduction in the tangible net worth requirement from $44 million to $25 million.

Additionally, just last week, LTL amended its existing warehouse line agreement with JP Morgan Chase Bank to lower the tangible net worth requirement there to $25 million as well. These reductions in tangible net worth requirements free up nearly $20 million in cash.

Now moving on to the Lending Tree Exchanges, revenue in the Exchanges segment was down $4.2 million, or 16% quarter over quarter on 20% fewer matched requests and 8% fewer closed loans on the lender network. However, in the year-over-year comparison, we see the Exchanges revenue grew 6%, which is due in part to an increase in inter-segment sales to LendingTree Loans. LTL received more volume from the Exchange at a higher price.

The year-over-year change is also due to our expansion into new non-mortgage mortgage verticals like education, home services and insurance. These new businesses combined now make up more than 15% of total Exchanges revenue.

Adjusted EBITDA for the Exchanges was down approximately $700,000 from Q1 at $3 million. This reflects the lower revenue previously mentioned, partially offset by lower operating expenses, primarily marketing. Specifically, operating costs decreased $3.3 million quarter-over-quarter largely due to $3 million less in marketing expense. The recent drop in mortgage interest rates brought an increase in consumer inquiries, which has in turn allowed us to hold our marketing expense as a percent of revenue flat to last quarter, all while continuing to test and invest in new volume sources.

Moving on to Real Estate, in our Real Estate segment, the difficult market influences such as low home prices and sluggish sales activity have not yet completely reversed themselves. However, we did see an increase in revenue in the quarter brought on by nearly 200 more closings over Q1. We also saw some stabilization in average home prices with the average value of a closing staying virtually level to the prior quarter at just under $200,000. Agent count at the end of Q2 was 12% lower than at the end of Q1. This, however, is due in part to an active focus by regional and local management to retain only the best agents to take advantage of our system of warm transferred Internet leads and online lead management.

Lastly, our Corporate segment. Corporate operating expenses decreased $300,000, or 7% quarter over quarter and $2.1 million, or 34% year over year. The quarter-over-quarter decrease largely reflects lower professional fees versus Q1. The year-over-year improvement is the result of lower G&A and product development costs due to our prior restructuring efforts.

As for guidance for the rest of the year, we expect that increasing interest rates will put pressure on the lending businesses, but we will be able to largely counter that with marketing and other cost cuts. The Tree.com launch later this summer will have little impact to the bottom line this year given our expected low margins in the businesses.

As for guidance for the rest of the year, we expect that increasing interest rates will put pressure on the lending business, but we will be able to largely counter that with marketing and other cost cuts. The Tree.com launch later this summer will have little impact on the bottom line this year given our expected low margins in those businesses as we make heavy marketing investments to grow them.

Putting all of this together, we would still expect our consolidated revenue for the remainder of 2010 to be down about 10% from 2009. We will keep our marketing and operating expense guidance expressed as a percentage of revenue the same and as a result, we are pushing to reach adjusted EBITDA between breakeven and $4 million for the second half of 2010.

Briefly turning to the balance sheet, we ended the quarter with approximately $73 million in cash, including $10 million of restricted cash, down $12 million from the end of Q1. The change from last quarter principally reflects share repurchases and outflow payments on the litigation matters and loan settlement discussions we had in Q4 '09. We have about $2.4 million remaining to pay on those loan settlement matters.

We ended the quarter with 10.8 million common shares outstanding with another 1 million options and 665,000 RSUs outstanding. Under our previously announced $10 million share repurchase program, which began in February with the opening of the trading window, we repurchased 408,568 shares in the quarter at an average price of $6.86 in open market transactions.

Including shares purchased before Q2 through June 30, we have repurchased 487,358 total shares at an average price of $7.12 per share and we have approximately $6.5 million of repurchased authorization remaining. And with that, I would like to hand it over to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Mahaney, Citi.

Neil Doshi - *Citigroup - Analyst*

Hey, Doug. Hey, Tamara. This is Neil Doshi speaking for Mark. We had a couple questions. I guess first was looks like your gross margin was very strong during the quarter. What kind of drove that strength and do you think this is sustainable? And then I have a couple more questions.

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

I think it is sustainable. I think -- look, at the end of the day, we have been getting -- we've been watching costs, we've been trying to optimize the per transaction economics of the business, the unit economics and that work continues and gross margin is a key part of that. Let me have Tamara add a little bit of color to that as well.

Tamara Kotronis - *Tree.com, Inc. - SVP, Financial Planning & Analysis & IR*

On the LTL front, we consistently look at process improvements and so we would expect to see that reflected in improved gross margin. So I think that is definitely sustainable.

Neil Doshi - *Citigroup - Analyst*

Okay, great. And then in terms of the EBITDA guidance that you gave, I guess flat to up $4 million for the second half, where do you think the pressure will come from? Is it mainly from the Exchanges or from LTL or from both?

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

What we are banking on is this. We are assuming that rate reductions can't continue and so baked into that is some rising rates. As rates rise, the customer acquisition costs go up higher because your marketing just gets harder to pull through. That is somewhat offset by then revenue increases on the exchange on a per unit basis, but it doesn't get you all the way there and so you have pressure. If rates continue to stay low, obviously, we would expect to do better than those numbers, but we are baking in -- we are assuming that the rate party can't last forever.

Neil Doshi - *Citigroup - Analyst*

And then I guess our final question is in terms of competition. It seems like Google is making a bigger push to go further down the purchase funnel and they are starting to offer or push consumers to the end provider when it comes to leads. They're doing this in mortgages, now credit cards and it's quite possible they'll start moving into autos and insurance. How do you reconcile that and is there a way where you can compete effectively with someone like Google or do they actually become a partner of yours? Maybe you can shed some light there, that would be great.

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

Sure. Yes, I think Google's strategy, particularly as we saw with the ITA acquisition and with what they've done in mortgage, that they are clearly trying to work -- that they see product-based searches as search and they don't want to just do keyword-based searches and they want to work with the end advertiser and squeeze out so-called aggregators. That is certainly a strategy and we have no doubt that Google, if they really focused on that, could certainly make that successful.

The way we plan to compete with that is, obviously, we will continue to buy search advertising and spend money with Google. We will try to do integrated partnerships with their competition and try to help make sure that it doesn't end up a purely Google world from a search perspective. But importantly, and this is where I think our Company is well positioned over the long term, particularly compared to most, is that we actually have a brand and at the end of the day, a lot of companies have built their model off of SEO and SEM just from Google. And while that is really nice, at the end of the day, you are very -- you are at Google's mercy if they decide to change the rules, whether it's a search algorithm or whether they try to then integrate into your business.

So what we are going to do -- what we do with LendingTree is we try to maintain a wide diversity of advertising, try to work on CRM, try to do off-line TV so we get people coming directly to us, try to do display advertising. We plan to do the same thing with Tree.com. We don't want to be dependent on Google.

At the same time, because we are -- because we actually have LendingTree loans, we also have a bit of a hedge against this. We are actually on the Google platform today as a lender, so we are buying leads from Google with our LendingTree Loans subsidiary and we think if that becomes a channel, we will make it work that way too. So if it is cheaper and more effective to get new customers to LendingTree through Google and through lead gen instead of buying search and then turning them into leads ourselves, we will certainly just do it that way. And there also, we think our brand will be very competitive against the other mortgage brands that are out there.

Neil Doshi - *Citigroup - Analyst*

Great. Thank you, Doug. Thank you, Tamara.

Operator

(Operator Instructions) George Askew, Stifel Nicolaus.

George Askew - *Stifel Nicolaus - Analyst*

Yes, good morning. I just wanted to clarify on guidance, I think you said you are going to expect to keep marketing expenses as a percent of revenue of about the same for the balance of the year. Is that based off the second-quarter percentage or the 40% you've talked about in the past or the first-quarter percentage? I just want to know what the same refers to.

Tamara Kotronis - *Tree.com, Inc. - SVP, Financial Planning & Analysis & IR*

The same is referring to Matt's guidance that he gave at the end of 2009, which is marketing as a percentage of revenue at 38% to 42%.

George Askew - *Stifel Nicolaus - Analyst*

Okay.

Tamara Kotronis - *Tree.com, Inc. - SVP, Financial Planning & Analysis & IR*

Which is slightly higher than what we had in Q2.

George Askew - *Stifel Nicolaus - Analyst*

Got you. Okay, good. You have clearly ramped up the number of mortgage leads from the exchange that had been used within LendingTree Loans in the quarter. I know that number will move up and down, but going forward, should we expect that the percentage of leads out of the exchange -- mortgage leads out of the exchange will be at an elevated level going into LTL?

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

Yes and -- I would say yes if the economics hold. So the way we think about this is we don't engineer this for any particular reason other than economics. What has happened at LendingTree Loans is they've gotten very, very good at not just taking what we call long format leads from LendingTree, but getting 800 leads, short form leads, short short form leads, etc., low loan amounts. Basically a lot of the things that the rest of the lender network doesn't find very valuable, we have worked on process improvements over the years to be able to have our own in-house lender be able to take every customer. We think that every customer deserves four offers and we want to work towards that goal and if we can't sell them to the exchange, we want to service them ourselves. So that's one key thing why you see that.

The second one is the economics of LTL versus the exchange. On an expected value basis, you make about three times as much revenue at LTL versus the exchange. So with those kind of economics, you can't help but send more there and so that helps. Now this will be offset by some things that we've done on the exchange. In particular, we rolled out recently state-specific pricing where lenders can also pay more to get more.

So it essentially creates a competitive bidding environment for lenders and if lenders want to get volume, they can up their bid for how many leads them want to get and they can -- then we don't need to be sort of engineering pricing; we let supply and demand drive that. If that drives up pricing on the exchange, inside of certain lead segments, it may get more profitable to send volume to the exchange versus LTL. Obviously, in general, there is a big spread, so we don't see that.

But then the other thing you should note too is you are fairly volume limited at LTL. So unlike the exchange, I can't flex capacity over the short term at LTL. I can close 1000 to 1300 loans a month probably at existing staff, but I couldn't do 3000 loans a month on the existing staff at LTL. We just don't have the production capacity to do that. So if we had a spike in volume, you would see, for example, those percentages change because more of that would flow over to the exchange. If you saw a reduction in volume, you would see that percentage really increase because a higher percentage of the volume would flow to LTL. Does that make sense?

George Askew - *Stifel Nicolaus - Analyst*

Yes, no, absolutely. That's a great answer. Okay, thank you.

Operator

(Operator Instructions). Reed Meyer, Stifel Nicolaus.

Reed Meyer - *Stifel Nicolaus - Analyst*

Hi, guys. Can you please discuss the year-over-year decline in matched requests? It would seem to us that despite the historically low mortgage rates, the lender demand for leads would still be high as mortgage applications are still relatively weak. Certainly nothing like the bump we saw last year. So can you discuss the year-over-year decline in matched requests and than are you hearing from lenders on their demand for matched requests?

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

Sure. Let's talk about the macro piece first and then we will go into -- and then we'll talk about rates. The key driver of this was the huge refi boom we were seeing last year. Last year in Q1 and Q2, you had all the federal programs, you had a big reduction in rates, and so you had volume just flooding us and so we had about 330,000 roughly loan requests.

We did not have -- we are not in refi boom territory this time around. And the reason is refi booms or volume -- it doesn't matter so much about the aggregate level of rates. Rates could be lower now than they were then, but it is really the rate of change of rates. So if you already have a 5% mortgage, if rates go to 4.75%, there is no need for you to refinance. The costs of your refinancing are not going to give you a benefit to do that. So you don't get -- even though rates are lower, you don't get the same spike in volume you get when you get a big change in rates. So we were seeing big changes last year, huge volume. We just don't see that.

The other thing that we talked a little bit about, which is one area we are struggling right now is in marketing. Part of it drives the -- I want to be transparent with you all about the things we're working on. We talked about this a little bit last quarter and I think this continues. I am seeing some very good signs, but at the same time, we certainly have a long way to go.

The good news about the business and where we are today, and this is your next question about lender demand, lenders are asking us for volume. Demand for leads is very high. Demand for LendingTree leads is very high and we are seeing pricing of those leads move up, we are seeing lenders ask for more leads, etc. So on the revenue and monetization side, I feel very, very good with not only sales, but technology and everything we have put in place on that side.

The problem is that, as we came out of Q4 -- last year was essentially refi boom most of the year and we were fundamentally not advertising very much. Once the revenue side got fixed coming into Q1, we started stepping on the gas again and some channels worked very well on the marketing side and some didn't. And we are now, with a new head of marketing, trying to fix particularly the online advertising of LendingTree.

The good news is, as I said, with the revenue being there and expected value very high, demand for leads very high, that gives us a lot of room to go spend marketing into that, but we are not there yet. So we are testing a lot. I am seeing some good signs in some tests, but it is not at the level that it needs to be for us to truly succeed. So we are hiring some new staff. We have put in a lot of new marketing technology and that marketing platform that we are trying to build and trying to scale is going to be critical. That was a surprise to the year, but something we are working very hard on.

Reed Meyer - *Stifel Nicolaus - Analyst*

Sure. That makes sense. And then much more of a macro question. certainly over the last several years, tight mortgage underwriting standards, a lack of high-margin products, Alt-A, subprime, nonconforming things and now with almost certainty, you are going to see higher rates moving forward with tight underwriting standards and the lack of these products. Given this

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environment, what are some of the growth drivers on the mortgage business? Are there levers you can pull and again, what are lenders telling you?

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

I think the biggest growth driver has to be share gains and in the mortgage business I think increasingly you see concentration, you see smaller guys not being able to succeed. Now, again, I say that, but then we get volumes spiking up again here late, very late in Q2 and into Q3 and that keeps people hanging on again. But I think what you really see is that this business is moving towards, much more towards a scale business where you need great processes, great technology, great management, great brand and a steady flow of leads.

The good news is we have all of that, but we are not as big as we need to be. So I think you continue to scale LendingTree loans up. And that certainly helps and then I think you continue to work with leading lenders who also have that level of scale, that is low cost, etc. It is costing a lot more to be a mortgage company, particularly with licensing at the individual level, state and federal regulations that are coming down the pike. The good news is that once you comply with all those things, while it is expensive, a lot of your competition can't. So we are going to see few fewer mortgage companies.

Now, the good news is I don't think -- we are not seeing any crimp on margin really at LTL and I think, quite frankly, the fewer competitors you have, the better margins are. That is probably not a good thing for the customer at the end of the day because there is not as much competition for their business, so we would like to see a lot more competition in the market. But margins at LTL are holding up quite nicely just because there is less competition out there. And then obviously any time you have a fall in rates or any refi volume, margins just expand considerably.

Reed Meyer - *Stifel Nicolaus - Analyst*

Okay, great. And then final question, plans on the additional $20 million in unencumbered cash?

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

Nothing specific. I think we are committed to staying on the buyback path. We think our stock is, at these levels, very attractively priced. So we are going to certainly continue to work on the authorization there. We are continuing to explore small tuck-in acquisitions in either new verticals. We are happy with how our education and home services acquisitions went. So if we can get people in here to help us build out some of those new verticals, that is good. And other than that, I think we are going to keep it, we are going to return it to shareholders through buybacks and we are going to -- and we are going to keep looking for tuck-ins and that is the plan.

But we don't want to -- we certainly don't want to be overcapitalized and anytime we can -- we want to be -- we are a long-term shareholder here as the Company and we have got a long-term view of this and we are going to -- when prices are attractive, we are going to keep buying it.

Reed Meyer - *Stifel Nicolaus - Analyst*

All right, great. Thank you for taking my questions.

Operator

(Operator Instructions). George Askew, Stifel Nicolaus.

George Askew - *Stifel Nicolaus - Analyst*

Yes, thank you. Doug, you mentioned your new head of marketing and I know there have been some other management changes at the Company this year. Are these changes behind you? Do you have the right team in place? Can you just comment on that, please?

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

I feel I think more bullish about the team than I have in years. So I think we have got a -- everybody who has been here has helped us in really key ways, so I don't want my comments in any way to be taken as disparaging anybody in the past. But I am thrilled with the people we have brought onboard and I am thrilled with where we are.

What the Company has basically done -- we have had to remake ourselves from a very big -- I don't want to say bureaucratic in a negative way, but we were building this Company from $80 million in EBITDA to hopefully $100 million in EBITDA, etc., getting -- seeing $1 million in revenue growth and all of a sudden, we have found ourselves talking about -- do you put SAP or Oracle in as your financial system. And this was several years ago, and it was just a very different company with a very different management team and a different set of skills.

And we have had to remake that to a much flatter organization, much leaner organization, decentralized decision-making, get people who are not in -- who don't sit in committees, who make decisions very rapidly and it is a much more entrepreneurial startup-like culture again. And we have had to do that while restructuring the business and cutting revenue.

I would say I feel very, very good now about our senior team. My philosophy is everybody at the Company, I want them to have 10 or 12 direct reports and I certainly do and I feel great about it. Morale is pretty high and so I feel good. And I am feeling even better -- as great as I feel about those people, I feel even better down in the organization. We are bringing in a lot of new people who have great skills and just fire in their eyes and are so excited for what we are doing. So I feel a lot of momentum on the people side.

George Askew - *Stifel Nicolaus - Analyst*

Great, thank you.

Operator

And seeing no further questions in our queue, I'll turn the conference back over to Mr. Doug Lebda for any additional or closing remarks.

Doug Lebda - *Tree.com, Inc. - Chairman & CEO*

Wonderful. Well, thank you all very much. I am pleased with our quarter here. As you all know, we are managing through some difficult times, up and down and it is not always smooth. I think this quarter, while revenue was down a little bit, EBITDA was obviously up substantially. We are managing the business I think smartly where we are not going to spend marketing dollars in anyway foolishly and we are going to manage this business to solid EBITDA returns. And I think we are doing that this year and we look forward to reporting results in a few more months. So thank you very much.

Operator

That does conclude today's conference. Thank you all for your participation and have a wonderful day.