Tree.com, Inc.
Form 10-Q
November 07, 2008

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the Quarterly Period Ended September 30, 2008**

**or**

o **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. 001-34063**

# TREE.COM, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **26-2414818** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**11115 Rushmore Drive, Charlotte, North Carolina 28277**
(Address of Registrant's principal executive offices)

**(704) 541-5351**
(Registrant's telephone number, including area code)

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 ý No o

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

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer o | Non-accelerated filer ý<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of November 5, 2008, there were 9,369,381 shares of the Registrant's common stock, par value $.01 per share, outstanding.

## PART 1 FINANCIAL INFORMATION

**Item 1.** ***Consolidated Financial Statements***

## TREE.COM, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

**(Unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2008** | **2007** | **2008** | **2007** |
| | (In thousands, except per share amounts) | | | |
| Revenue | | | | |
| Lending: | | | | |
| Origination and sale of loans | $ 17,911 | $ 22,418 | $ 68,739 | $ 116,385 |
| Other lending | 22,566 | 38,750 | 83,317 | 136,832 |
| Total Lending | 40,477 | 61,168 | 152,056 | 253,217 |
| Real Estate | 9,781 | 13,785 | 28,378 | 42,374 |
| Total revenue | 50,258 | 74,953 | 180,434 | 295,591 |
| Cost of revenue | | | | |
| Lending | 9,895 | 11,271 | 34,096 | 38,915 |
| Real Estate | 5,883 | 7,008 | 16,823 | 20,802 |
| Total cost of revenue (exclusive of depreciation shown separately below) | 15,778 | 18,279 | 50,919 | 59,717 |
| Gross margin | 34,480 | 56,674 | 129,515 | 235,874 |
| Operating expenses | | | | |
| Selling and marketing expense | 25,992 | 43,755 | 90,472 | 157,085 |
| General and administrative expense | 22,775 | 23,166 | 58,648 | 80,726 |
| Product development | 1,779 | 3,844 | 5,331 | 12,010 |
| Proceeds from a litigation settlement | | (15,000) | | (15,000) |
| Restructuring expense | 2,394 | 6,401 | 4,557 | 10,999 |
| Amortization and impairment of intangibles | 2,204 | 3,993 | 42,910 | 14,280 |
| Depreciation | 1,791 | 2,431 | 5,337 | 7,850 |
| Goodwill impairment | | | 130,957 | |
| Total operating expenses | 56,935 | 68,590 | 338,212 | 267,950 |
| Operating loss | (22,455) | (11,916) | (208,697) | (32,076) |
| Other income (expense) | | | | |
| Interest income | 2 | 367 | 13 | 644 |
| Interest expense | (169) | (236) | (497) | (757) |
| Other income (expense) | (2) | 13 | (4) | 14 |
| Total other income (expense), net | (169) | 144 | (488) | (99) |
| Loss before income taxes | (22,624) | (11,772) | (209,185) | (32,175) |
| Income tax benefit | 73 | 5,478 | 13,915 | 13,266 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net loss | $ | (22,551) | $ | (6,294) | $ | (195,270) | $ | (18,909) |
| Net loss per share available to common shareholders | | | | | | | | |
| Basic | $ | (2.41) | $ | (0.67) | $ | (20.85) | $ | (2.03) |
| Diluted | $ | (2.41) | $ | (0.67) | $ | (20.85) | $ | (2.03) |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

**TREE.COM, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

| | September 30, 2008 (unaudited) | December 31, 2007 (audited) |
|---|---|---|
| | (In thousands) | |
| **ASSETS** | | |
| Cash and cash equivalents | $ 82,413 | $ 45,940 |
| Restricted cash and cash equivalents | 15,825 | 14,953 |
| Accounts receivable, net of allowance of $524 and $322, respectively | 9,044 | 12,433 |
| Loans held for sale ($63,258 measured at fair value in 2008) | 65,910 | 86,754 |
| Deferred income taxes | 6,420 | 6,420 |
| Prepaid and other current assets | 6,914 | 6,011 |
| Total current assets | 186,526 | 172,511 |
| Property and equipment, net | 18,121 | 21,466 |
| Goodwill | 9,285 | 140,892 |
| Intangible assets, net | 65,680 | 108,440 |
| Other non-current assets | 170 | 278 |
| Total assets | $ 279,782 | $ 443,587 |
| **LIABILITIES:** | | |
| Warehouse lines of credit | $ 56,803 | $ 79,426 |
| Notes payable | | 20,196 |
| Accounts payable, trade | 5,023 | 3,335 |
| Deferred revenue | 1,377 | 1,435 |
| Income taxes payable | 3,373 | 993 |
| Accrued expenses and other current liabilities | 45,896 | 83,613 |
| Total current liabilities | 112,472 | 188,998 |
| Income taxes payable | 819 | 730 |
| Other long-term liabilities | 2,157 | 2,529 |
| Deferred income taxes | 22,441 | 36,706 |
| Total liabilities | 137,889 | 228,963 |
| Commitments and contingencies (Note 11) | | |
| **SHAREHOLDERS' EQUITY:** | | |
| Preferred stock $.01 par value; authorized 5,000,000 shares; none issued or outstanding | | |
| Common stock $.01 par value; authorized 50,000,000 shares; issued and outstanding 9,368,571 and -0- shares, respectively | 94 | |
| Invested capital | | 751,923 |
| Additional paid-in capital | 891,336 | |
| Payables to IAC and subsidiaries | | 20,067 |
| Accumulated deficit | (749,537) | (557,366) |
| Total shareholders' equity | 141,893 | 214,624 |
| Total liabilities and shareholders' equity | $ 279,782 | $ 443,587 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

**TREE.COM, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

**(Unaudited)**

| | **Total** | **Invested Capital** | **Common Stock Number of Shares** | **Common Stock Amount** | **Additional Paid-in Capital** | **Payables to IAC and Subsidiaries** | **Accumulated Deficit** |
|---|---|---|---|---|---|---|---|
| | | | | (In thousands) | | | |
| **Balance as of December 31, 2007** | $ 214,624 | $ 751,923 | | $ | $ | $ 20,067 | $ (557,366) |
| Comprehensive loss: | | | | | | | |
| Net loss for the nine months ended September 30, 2008 | (195,270) | | | | | | (195,270) |
| Comprehensive loss | (195,270) | | | | | | |
| Cumulative effect of adoption of SFAS No. 157 | 3,099 | | | | | | 3,099 |
| Non-cash compensation | 10,024 | | | | 10,024 | | |
| Contribution from IAC, net of extinguishment of intercompany amounts | 109,322 | (751,923) | | | 881,312 | (20,067) | |
| Issuance of common stock upon spin off | 94 | | 9,367 | 94 | | | |
| Issuance of common stock upon exercise of stock options and vesting of restricted stock units, net of withholding taxes received upon spin off | | | 2 | | | | |
| **Balance as of September 30, 2008** | $ 141,893 | $ | 9,369 | $ 94 | $ 891,336 | $ | $ (749,537) |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

**TREE.COM, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2008** | **2007** |
| | **(In thousands)** | |
| **Cash flows from operating activities:** | | |
| Net loss | $ (195,270) | $ (18,909) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Amortization and impairment of intangibles | 42,910 | 14,280 |
| Depreciation | 5,337 | 7,850 |
| Goodwill impairment | 130,957 | |
| Non-cash compensation expense | 10,024 | 2,952 |
| Non-cash restructuring expense | 1,092 | 2,446 |
| Deferred income taxes | (13,916) | (4,532) |
| Gain on origination and sale of loans held for sale | (68,739) | (116,385) |
| Loss on impaired loans not sold | 265 | 264 |
| Loss on sale of real estate acquired in satisfaction of loans | 202 | 219 |
| Bad debt expense | 577 | 1,918 |
| Non-cash interest expense | 76 | 684 |
| Changes in current assets and liabilities: | | |
| Accounts receivable | 2,812 | 1,006 |
| Origination of loans held for sale | (1,728,458) | (5,038,544) |
| Proceeds from sales of loans held for sale | 1,816,273 | 5,358,348 |
| Principal payments received on loans held for sale | 697 | 3,230 |
| Payments to investors for loan repurchases and early payoff obligations | (3,780) | (5,031) |
| Prepaid and other current assets | 2,988 | 2,056 |
| Accounts payable and other current liabilities | (17,842) | (4,870) |
| Income taxes payable | 2,376 | (10,018) |
| Deferred revenue | (309) | (1,714) |
| Other, net | (118) | (190) |
| **Net cash (used in) provided by operating activities** | (11,846) | 195,060 |
| **Cash flows from investing activities:** | | |
| Contingent consideration paid to former shareholders of Home Loan Center and iNest | (14,487) | (984) |
| Capital expenditures | (3,322) | (7,544) |
| Other, net | (142) | 33 |
| **Net cash used in investing activities** | (17,951) | (8,495) |
| **Cash flows from financing activities:** | | |
| Borrowing under warehouse lines of credit | 1,586,413 | 4,902,649 |
| Repayments of warehouse lines of credit | (1,609,036) | (5,097,131) |
| Principal payments on long-term obligations | (20,045) | (11,289) |
| Transfers to IAC | | (25,144) |
| Capital contributions from IAC | 109,417 | |
| Excess tax benefits from stock-based awards | 393 | 1,009 |
| (Increase) decrease in restricted cash | (872) | 41 |
| **Net cash provided by (used in) financing activities** | 66,270 | (229,865) |
| **Net increase (decrease) in cash and cash equivalents** | 36,473 | (43,300) |

| | | |
|---|---|---|
| Cash and cash equivalents at beginning of period | 45,940 | 99,498 |
| **Cash and cash equivalents at end of period** | $ 82,413 | $ 56,198 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1 ORGANIZATION

### Spin-Off

On August 20, 2008, Tree.com, Inc. ("Tree.com") was spun off from its parent company, IAC/InterActiveCorp ("IAC") into a separate publicly traded company. In these consolidated financial statements, we refer to the separation transaction as the "spin-off." In connection with the spin-off, Tree.com was incorporated as a Delaware corporation in April 2008. Tree.com consists of the businesses that formerly comprised IAC's Lending and Real Estate segments. We refer herein to these businesses as the "Tree.com Businesses," which include LendingTree.com, RealEstate.com, GetSmart.com, Home Loan Center, Inc. (d/b/a LendingTree Loans) and iNest.com.

In conjunction with the spin-off, Tree.com completed the following transactions: (1) extinguished all intercompany payable balances with IAC, which totaled $57.2 million by recording a non-cash contribution from IAC, (2) recapitalized the invested capital balances with common stock, whereby holders of IAC stock received shares of Tree.com stock based on a formula as described in our Registration Statement on Form S-1, as amended (Commission file number 333-152700), filed with the Securities and Exchange Commission ("SEC"), and (3) received $55.2 million of cash from IAC to bring Tree.com's cash balance to $110.0 million upon the seperation from IAC.

### Basis of Presentation

The historical consolidated financial statements of Tree.com and its subsidiaries reflect the contribution or other transfer to Tree.com of all of the subsidiaries and assets and the assumption by Tree.com of all of the liabilities relating to the Tree.com Businesses in connection with the spin-off and the allocation to Tree.com of certain IAC corporate expenses relating to the Tree.com Businesses. Accordingly, the historical consolidated financial statements of Tree.com reflect the historical financial position, results of operations and cash flows of the Tree.com Businesses since their respective dates of acquisition by IAC, based on the historical consolidated financial statements and accounting records of IAC and using the historical results of operations and historical bases of the assets and liabilities of the Tree.com Businesses with the exception of accounting for income taxes. For purposes of these financial statements, income taxes have been computed for Tree.com on an as if stand-alone, separate tax return basis. Intercompany transactions and accounts have been eliminated.

In the opinion of Tree.com's management, the assumptions underlying the historical consolidated financial statements of Tree.com are reasonable. However, this financial information does not necessarily reflect what the historical financial position, results of operations and cash flows of Tree.com would have been had Tree.com been a stand-alone company during the periods presented.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of Tree.com's management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Interim results are not necessarily indicative of the results that may be expected for a full year. The accompanying unaudited consolidated financial statements should be read in conjunction with Tree.com's audited consolidated financial statements and notes thereto for the year ended December 31, 2007.

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 1 ORGANIZATION (Continued)**

**Company Overview**

*Lending*

Lending consists of online networks (principally LendingTree.com and GetSmart.com) and call centers that connect consumers and financial providers in the lending industry. Tree.com also originates, processes, approves and funds various residential real estate loans through Home Loan Center, Inc. ("HLC"), which does business as LendingTree Loans in certain jurisdictions. The HLC and LendingTree Loans brand names are collectively referred to in these consolidated financial statements as "LendingTree Loans."

*Real Estate*

Real Estate consists of a proprietary full service real estate brokerage (RealEstate.com, REALTORS®) that operates in fourteen U.S. markets, as well as an online network accessed at *www.RealEstate.com*, that connects consumers with real estate brokerages around the country, and iNest.com, an online network that matches buyers and builders of new homes.

Tree.com maintains operations solely in the United States.

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES**

**Accounting Estimates**

Tree.com's management is required to make certain estimates and assumptions during the preparation of its consolidated financial statements in accordance with U.S. generally accepted accounting principles ("GAAP"). These estimates and assumptions impact the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the consolidated financial statements. They also impact the reported amount of net earnings during any period. Actual results could differ from those estimates.

Significant estimates underlying the accompanying consolidated financial statements include: valuation allowance for impaired loans held for sale; reserve for obligations on loans that have been previously sold; the fair value of loans held for sale and related derivatives; the recoverability of long-lived assets; the recovery of goodwill and intangible assets; the determination of income taxes payable and deferred income taxes, including related valuation allowances; various other allowances, reserves and accruals; and assumptions related to the determination of stock-based compensation.

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Restricted Cash and Cash Equivalents**

Restricted cash and cash equivalents consists of the following (in thousands):

| | September 30, 2008 | December 31, 2007 |
|---|---|---|
| Cash in escrow for future operating lease commitments | $ 5,900 | $ |
| Cash in escrow for surety bonds | 5,000 | |
| Cash in escrow for corporate purchasing card program | 2,200 | |
| Minimum required balances for warehouse lines of credit | 1,000 | 13,900 |
| Other | 1,725 | 1,053 |
| Total restricted cash and cash equivalents | $ 15,825 | $ 14,953 |

**Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51" ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. SFAS No. 160 will be applied prospectively, except as it relates to disclosures, for which the effects will be applied retrospectively for all periods presented. Early adoption is not permitted. Tree.com is currently assessing the impact of SFAS No. 160 on its consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141R"), which replaces FASB Statement No. 141. SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The Statement also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations in fiscal years beginning after December 15, 2008. Early adoption is not permitted. Tree.com is currently assessing the impact of the adoption of SFAS No. 141R on its consolidated financial position, results of operations and cash flows.

**NOTE 3 GOODWILL AND INTANGIBLE ASSETS**

In the second quarter of 2008, Tree.com recorded impairment charges of $131.0 million and $33.4 million related to goodwill and an indefinite-lived intangible asset, respectively. The charges associated with Lending were $70.2 million related to goodwill and $33.4 million related to an

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 3 GOODWILL AND INTANGIBLE ASSETS (Continued)**

indefinite-lived intangible asset. The charge related to Real Estate was a goodwill impairment charge of $60.8 million.

The impairments at Tree.com resulted from the Company's most recent reassessment of the likely future profitability of Lending and Real Estate in light of the adverse developments in the mortgage and real estate market conditions and the operational strategies Tree.com has undertaken in response to these market realities. These adverse conditions include, among others, constrained liquidity, lender focus on low margin conforming loans, uncertainty as to the eventuality and timing of the return of higher margin mortgage offerings, the decline in real estate values and a high rate of delinquency for existing mortgages. Tree.com updated its assessment of mortgage and real estate market conditions and Tree.com's responsive operational strategies during the second quarter of 2008, and quantified these considerations in Tree.com's future forecasted results.

The balance of goodwill and intangible assets, net is as follows (in thousands):

| | September 30, 2008 | December 31, 2007 |
|---|---|---|
| Goodwill | $ 9,285 | $ 140,892 |
| Intangible assets with indefinite lives | 55,229 | 88,607 |
| Intangible assets with definite lives, net | 10,451 | 19,833 |
| Total goodwill and intangible assets, net | $ 74,965 | $ 249,332 |

Intangible assets with indefinite lives relate principally to trade names and trademarks acquired in various acquisitions. At September 30, 2008, intangible assets with definite lives relate to the following (in thousands):

| | Cost | Accumulated Amortization | Net | Weighted Average Amortization Life (Years) |
|---|---|---|---|---|
| Purchase agreements | $ 76,117 | $ (67,751) | $ 8,366 | 5.7 |
| Technology | 29,100 | (29,056) | 44 | 3.0 |
| Customer lists | 6,607 | (6,607) | | 2.8 |
| Other | 9,078 | (7,037) | 2,041 | 4.8 |
| Total | $ 120,902 | $ (110,451) | $ 10,451 | |

At December 31, 2007, intangible assets with definite lives relate to the following (in thousands):

| | Cost | Accumulated Amortization | Net | Weighted Average Amortization Life (Years) |
|---|---|---|---|---|
| Purchase agreements | $ 76,117 | $ (59,212) | $ 16,905 | 5.7 |
| Technology | 29,100 | (28,663) | 437 | 3.0 |
| Customer lists | 6,607 | (6,607) | | 2.8 |
| Other | 8,928 | (6,437) | 2,491 | 4.9 |
| Total | $ 120,752 | $ (100,919) | $ 19,833 | |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 3 GOODWILL AND INTANGIBLE ASSETS (Continued)**

Amortization of intangible assets with definite lives is computed on a straight-line basis and, based on September 30, 2008 balances, such amortization for the next five years is estimated to be as follows (in thousands):

| | Amount |
|---|---|
| Three months ending December 31, 2008 | $ 1,388 |
| Year ending December 31, 2009 | 4,188 |
| Year ending December 31, 2010 | 2,818 |
| Year ending December 31, 2011 | 1,231 |
| Year ending December 31, 2012 | 826 |
| | $ 10,451 |

The following table presents the balance of goodwill by segment, including changes in the carrying amount of goodwill, for the nine months ended September 30, 2008 (in thousands):

| | Balance as of January 1, 2008 | Additions | (Deductions) | Impairments | Balance as of September 30, 2008 |
|---|---|---|---|---|---|
| Lending | $ 70,766 | $ | $ (615) | $ (70,151) | $ |
| Real Estate | 70,126 | | (35) | (60,806) | 9,285 |
| Total | $ 140,892 | $ | $ (650) | $ (130,957) | $ 9,285 |

Deductions principally relate to the establishment of deferred tax assets related to acquired tax attributes and the income tax benefit realized pursuant to the exercise of stock options assumed in a business acquisition that were vested at the transaction date and are treated as a reduction in goodwill when the income tax deductions are realized. The impairments are described above.

**NOTE 4 PROPERTY AND EQUIPMENT**

The balance of property and equipment, net is as follows (in thousands):

| | September 30, 2008 | December 31, 2007 |
|---|---|---|
| Computer equipment and capitalized software | $ 36,126 | $ 35,183 |
| Leasehold improvements | 3,463 | 3,076 |
| Furniture and other equipment | 5,133 | 3,737 |
| Projects in progress | 2,504 | 5,002 |
| | 47,226 | 46,998 |
| Less: accumulated depreciation and amortization | (29,105) | (25,532) |
| Total property and equipment, net | $ 18,121 | $ 21,466 |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 5 ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following (in thousands):

| | September 30, 2008 | December 31, 2007 |
|---|---|---|
| Accrued loan loss liability related to loans previously sold | $ 11,062 | $ 13,886 |
| Litigation accruals | 3,634 | 15,285 |
| Accrued advertising expense | 8,621 | 11,492 |
| Accrued compensation and benefits | 5,471 | 8,407 |
| Accrued restructuring costs | 3,475 | 5,560 |
| Other | 13,633 | 28,983 |
| Total accrued expenses and other current liabilities | $ 45,896 | $ 83,613 |

The other category above reflects an earnout payable related to the HLC acquisition, customer security deposits, accrued professional fees and other miscellaneous accrued expenses.

In 2008, Tree.com settled a litigation matter and paid $11.75 million, which was included in the December 31, 2007 accrual balance noted above.

**NOTE 6 WAREHOUSE LINES OF CREDIT**

Borrowings on warehouse lines of credit were $56.8 million and $79.4 million at September 30, 2008 and December 31, 2007, respectively. Borrowings under these lines of credit are used to fund, and are secured by, consumer residential loans that are held for sale. Loans under these lines of credit are repaid from proceeds from the sales of loans held for sale by LendingTree Loans. The interest rate under these lines of credit is 30-day LIBOR plus 75 to 140 basis points, but may vary under certain circumstances. Borrowings under all of LendingTree Loans' lines of credit are non-recourse to Tree.com.

As of September 30, 2008, LendingTree Loans had committed lines of credit totaling $100 million, of which $50 million was scheduled to expire on October 31, 2008, and another $50 million expires on January 24, 2009, and an uncommitted line of credit of $150 million. The $50 million committed line of credit that expires on January 24, 2009 and the $150 million uncommitted line are provided by the same lender. The $50 million committed line that was scheduled to expire on October 31, 2008 has been extended for 60 days. Both parties continue to work on renewal of the line and anticipate having the final terms agreed to prior to the end of the extension on December 30, 2008. The $50 million committed line of credit that expires on January 24, 2009 can be cancelled at the option of the lender without default upon sixty days notice. However, if the lender determines at any time prior to January 24, 2009 that the spin-off materially and adversely affects LendingTree Loans, the lender reserves the right to deem the line of credit expired prior to January 24, 2009. Under the terms of the committed lines of credit, LendingTree Loans is required to maintain various financial and other covenants. These financial covenants include, but are not limited to, maintaining (i) minimum levels of tangible net worth, cash on hand with a certain lender and liquid assets, (ii) a maximum ratio of total liabilities to net worth and (iii) positive pre-tax net income on a quarterly basis. During the three months ended September 30, 2008, LendingTree Loans was not in compliance with the quarterly positive pre-tax net income covenant. LendingTree Loans received a waiver of this covenant breach on October 28, 2008.

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 7 SEGMENT INFORMATION**

The overall concept that Tree.com employs in determining its operating segments and related financial information is to present them in a manner consistent with how the chief operating decision maker and executive management view the businesses, how the businesses are organized as to segment management, and the focus of the businesses with regards to the types of products or services offered or the target market.

Tree.com's primary metric is Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"), which is defined as operating income excluding, if applicable: (1) depreciation expense, (2) non-cash compensation expense, (3) amortization and impairment of intangibles, (4) goodwill impairment, (5) pro forma adjustments for significant acquisitions, and (6) one-time items. Tree.com believes this measure is useful to investors because it represents the operating results from Tree.com's segments, but excluding the effects of any other non-cash expenses. EBITDA has certain limitations in that it does not take into account the impact to Tree.com's statement of operations of certain expenses, including depreciation, non-cash compensation and acquisition related accounting.

The following tables reconcile EBITDA to operating loss for Tree.com's operating segments and to net loss in total (in thousands):

| | For the Three Months Ended September 30, 2008: | | | | | |
|---|---|---|---|---|---|---|
| | EBITDA | Non-Cash Compensation Expense | Goodwill Impairment | Amortization of Intangibles | Depreciation Expense | Operating Loss |
| Lending | $ (8,938) | $ (5,090) | $ | $ (1,116) | $ (1,336) | $ (16,480) |
| Real Estate | (1,717) | (2,715) | | (1,088) | (455) | (5,975) |
| Total | $ (10,655) | $ (7,805) | $ | $ (2,204) | $ (1,791) | (22,455) |
| Other expense, net | | | | | | (169) |
| Loss before income taxes | | | | | | (22,624) |
| Income tax benefit | | | | | | 73 |
| Net loss | | | | | | $ (22,551) |

| | For the Three Months Ended September 30, 2007: | | | | | |
|---|---|---|---|---|---|---|
| | EBITDA | Non-Cash Compensation Expense | Goodwill Impairment | Amortization of Intangibles | Depreciation Expense | Operating Loss |
| Lending | $ (1,372) | $ (287) | $ | $ (2,853) | $ (2,143) | $ (6,655) |
| Real Estate | (3,647) | (186) | | (1,140) | (288) | (5,261) |
| Total | $ (5,019) | $ (473) | $ | $ (3,993) | $ (2,431) | (11,916) |
| Other income, net | | | | | | 144 |
| Loss before income taxes | | | | | | (11,772) |
| Income tax benefit | | | | | | 5,478 |
| Net loss | | | | | | $ (6,294) |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 7 SEGMENT INFORMATION (Continued)**

| For the Nine Months Ended September 30, 2008: | EBITDA | Non-Cash Compensation Expense | Goodwill Impairment | Amortization and Impairment of Intangibles | Depreciation Expense | Operating Loss |
|---|---|---|---|---|---|---|
| Lending | $(11,059) | $ (6,592) | $ (70,151) | $ (39,626) | $ (4,012) | $(131,440) |
| Real Estate | (8,410) | (3,432) | (60,806) | (3,284) | (1,325) | (77,257) |
| Total | $(19,469) | $ (10,024) | $ (130,957) | $ (42,910) | $ (5,337) | (208,697) |
| Other expense, net | | | | | | (488) |
| Loss before income taxes | | | | | | (209,185) |
| Income tax benefit | | | | | | 13,915 |
| Net loss | | | | | | $(195,270) |

| For the Nine Months Ended September 30, 2007: | EBITDA | Non-Cash Compensation Expense | Goodwill Impairment | Amortization of Intangibles | Depreciation Expense | Operating Loss |
|---|---|---|---|---|---|---|
| Lending | $ 7,926 | $ (1,920) | $ | $ (8,630) | $ (6,959) | $ (9,583) |
| Real Estate | (14,920) | (1,032) | | (5,650) | (891) | (22,493) |
| Total | $ (6,994) | $ (2,952) | $ | $ (14,280) | $ (7,850) | (32,076) |
| Other expense, net | | | | | | (99) |
| Loss before income taxes | | | | | | (32,175) |
| Income tax benefit | | | | | | 13,266 |
| Net loss | | | | | | $ (18,909) |

Non-cash compensation expense in the tables above is included in the following line items in the accompanying consolidated statements of operations for the three and nine months ended September 30, 2008 and 2007 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Cost of revenue | $ 600 | $ 84 | $ 762 | $ 260 |
| Selling and marketing expense | 659 | 93 | 836 | 285 |
| General and administrative expense | 6,534 | 295 | 8,412 | 2,404 |
| Product development | 12 | 1 | 14 | 3 |
| Non-cash compensation expense | $ 7,805 | $ 473 | $10,024 | $ 2,952 |

Non-cash compensation expense for the three and nine months ended September 30, 2008 includes $6.6 million of expense due to the modification of equity-based awards related to the spin-off, which consists of the accelerated vesting of certain restricted stock units and the modification of vested stock options.

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 7 SEGMENT INFORMATION (Continued)**

Significant components of revenue for the three and nine months ended September 30, 2008 and 2007 are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Lending: | | | | |
| Origination and sale of loans | $17,911 | $22,418 | $ 68,739 | $116,385 |
| Match fees | 12,120 | 19,076 | 45,780 | 65,283 |
| Closed loan fees | 8,196 | 15,566 | 29,092 | 54,219 |
| Other | 2,250 | 4,108 | 8,445 | 17,330 |
| Total Lending revenue | 40,477 | 61,168 | 152,056 | 253,217 |
| Real Estate revenue | 9,781 | 13,785 | 28,378 | 42,374 |
| Total | $50,258 | $74,953 | $180,434 | $295,591 |

**NOTE 8 EARNINGS PER SHARE AND STOCK-BASED COMPENSATION**

The following table sets forth the computation of Basic and Diluted GAAP earnings per share:

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2008 | | 2007 | |
| | Basic | Diluted | Basic | Diluted |
| | (In thousands, except per share data) | | | |
| **Numerator:** | | | | |
| Net loss available to common shareholders | $ (22,551) | $ (22,551) | $ (6,294) | $ (6,294) |
| **Denominator:** | | | | |
| Weighted average common shares(a) | 9,367 | 9,367 | 9,328 | 9,328 |
| Net loss per common share | $ (2.41) | $ (2.41) | $ (0.67) | $ (0.67) |

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2008 | | 2007 | |
| | Basic | Diluted | Basic | Diluted |
| | (In thousands, except per share data) | | | |
| **Numerator:** | | | | |
| Net loss available to common shareholders | $ (195,270) | $ (195,270) | $ (18,909) | $ (18,909) |
| **Denominator:** | | | | |
| Weighted average common shares(a) | 9,367 | 9,367 | 9,328 | 9,328 |
| Net loss per common share | $ (20.85) | $ (20.85) | $ (2.03) | $ (2.03) |

(a) The weighted average common shares for the three and nine months ended September 30, 2007 and for the period from January 1, 2008 until the spin-off from IAC

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 8 EARNINGS PER SHARE AND STOCK-BASED COMPENSATION (Continued)**

is equal to the number of shares outstanding immediately following the spin-off from IAC.

The forms of stock-based awards granted to Tree.com employees are principally restricted stock units ("RSUs") and stock options. RSUs are awards in the form of phantom shares or units, denominated in a hypothetical equivalent number of shares of Tree.com common stock and with the value of each award equal to the fair value of Tree.com common stock at the date of grant. Each RSU and stock option grant is subject to service-based vesting, where a specific period of continued employment must pass before an award vests. Tree.com recognizes expense for all RSUs and stock options for which vesting is considered probable. For RSU and stock option grants the accounting charge is measured at the grant date as the fair value of Tree.com common stock and expensed ratably as non-cash compensation over the vesting term.

The amount of stock-based compensation expense recognized in the consolidated statement of operations is reduced by estimated forfeitures, as the amount recorded is based on awards ultimately expected to vest. The forfeiture rate is estimated at the grant date based on historical experience and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the estimated rate.

The following table sets forth the vesting schedule for RSUs as of September 30, 2008, excluding estimated forfeitures:

| Year Ending December 31, | Number of RSUs | % of Total |
|---|---|---|
| 2008 | 20 | 1% |
| 2009 | 182,144 | 36% |
| 2010 | 192,610 | 38% |
| 2011 | 87,374 | 17% |
| 2012 | 32,634 | 6% |
| 2013 | 8,757 | 2% |
| Total | 503,539 | 100% |

The following table sets forth the vesting schedule for stock options as of September 30, 2008, excluding estimated forfeitures:

| Year Ending December 31, | Number of Options | % of Total |
|---|---|---|
| Vested and unexercised | 219,906 | 12% |
| 2008 | 1,960 | % |
| 2009 | 97,396 | 5% |
| 2010 | 221,269 | 12% |
| 2011 | 94,625 | 5% |
| 2012 | 94,625 | 5% |
| 2013 | 1,179,700 | 61% |
| Total | 1,909,481 | 100% |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 8 EARNINGS PER SHARE AND STOCK-BASED COMPENSATION (Continued)**

Stock options in the table above are separated by strike price range as follows:

| Strike Price Range | Number of Options | % of Total |
|---|---|---|
| $.01 to $4.99 | 25,289 | 1% |
| $5.00 to $7.45 | 27,129 | 1% |
| $7.46 to $9.99 | 994,285 | 52% |
| $10.00 to $14.99 | 135,923 | 7% |
| $15.00 to $19.99 | 87,329 | 5% |
| $20.00 to $24.99 | 48,550 | 3% |
| Greater than $25.00 | 590,976 | 31% |
| Total | 1,909,481 | 100% |

**NOTE 9 FAIR VALUE MEASUREMENTS**

Effective January 1, 2008, Tree.com adopted SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). In accordance with SFAS No. 157, Tree.com categorizes its assets and liabilities measured at fair value into a fair value hierarchy that prioritizes the assumptions used in pricing the asset or liability into the following three levels:

Level 1: Observable inputs such as quoted prices for identical assets and liabilities in active markets obtained from independent sources.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs that are derived principally from or corroborated by observable market data.

Level 3: Unobservable inputs for which there is little or no market data and require Tree.com to develop its own assumptions, based on the best information available in the circumstances, about the assumptions market participants would use in pricing the asset or liability.

The following table presents Tree.com's assets and liabilities that are measured at fair value on a recurring basis at September 30, 2008 (in thousands):

| | Recurring Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Quoted Market Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value Measurements |
| Loans held for sale | $ | $ 62,767 | $ 491 | $ 63,258 |
| Interest rate lock commitments ("IRLCs") and forward delivery contracts | | 1,320 | 2,280 | 3,600 |
| Total | $ | $ 64,087 | $ 2,771 | $ 66,858 |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 9 FAIR VALUE MEASUREMENTS (Continued)**

The following table presents the changes in Tree.com's assets and liabilities that are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

| | Interest Rate Lock Commitments and Forward Delivery Contracts | | Loans Held for Sale | |
|---|---|---|---|---|
| | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2008 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2008 |
| Balance at beginning of period | $ 3,059 | $ 3,465 | $ | $ |
| Total net gains or losses (realized and unrealized) included in earnings | 13,028 | 39,586 | (692) | (692) |
| Transfers of IRLCs to closed loans | (13,827) | (39,699) | | |
| Purchase, sales, issuances and settlements, net | | | (1,397) | (1,397) |
| Transfers in and/or out of Level 3 | 20 | (1,072) | 2,580 | 2,580 |
| Balance at September 30, 2008 | $ 2,280 | $ 2,280 | $ 491 | $ 491 |

The following table presents the gains included in earnings for the three and nine months ended September 30, 2008 relating to Tree.com's assets and liabilities that are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

| | Interest Rate Lock Commitments and Forward Delivery Contracts | | Loans Held for Sale | |
|---|---|---|---|---|
| | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2008 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2008 |
| Total net gains or (losses) included in earnings, which are included in revenue | $ 13,028 | $ 39,586 | $ (692) | $ (692) |
| Change in unrealized gains or (losses) relating to assets and liabilities still held at September 30, 2008, which are included in revenue | $ 2,280 | $ 2,280 | $ (210) | $ (210) |

LendingTree Loans hedges the changes in fair value of certain loans held for sale primarily by entering into mortgage forward delivery contracts. Although LendingTree Loans continues to enter into forward delivery contracts for risk management purposes, effective April 1, 2007 it no longer designates these derivatives as hedges for accounting purposes. When hedge accounting was discontinued, the affected loans held for sale were no longer adjusted for changes in fair value. However, the changes in fair value of the forward delivery contracts continued to be recognized in current earnings as a

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 9 FAIR VALUE MEASUREMENTS (Continued)**

component of revenue. The fair value of the forward delivery contracts is recorded in "Prepaid and other current assets" and/or "Accrued expenses and other current liabilities" in the accompanying consolidated balance sheets. For the three and nine months ended September 30, 2008, Tree.com recognized gains of $0.4 million and $1.2 million, respectively, related to the changes in fair value of forward delivery contracts related to loans held for sale.

LendingTree Loans enters into commitments with consumers to originate loans at a specified interest rate (interest rate lock commitments "IRLCs"). Tree.com reports IRLCs as derivative instruments at fair value in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). Accordingly, LendingTree Loans determines the fair value of IRLCs using current secondary market prices for underlying loans with similar coupons, maturity and credit quality, subject to the anticipated loan funding probability. The fair value of IRLCs is subject to change primarily due to changes in interest rates and the loan funding probability. Under LendingTree Loans' risk management policy, LendingTree Loans hedges the changes in fair value of IRLCs primarily by entering into mortgage forward delivery contracts which can reduce the volatility of economic outcomes. IRLCs and the related hedging instruments are recorded at fair value with changes in fair value being recorded in current earnings as a component of revenue in the statement of operations.

Prior to the adoption of SFAS No. 157 the recognition of gains and losses at the inception of a derivative contract were prohibited unless the fair value of the contract was evidenced by a quoted price in an active market. As no active market exists for IRLCs, such day one gains and losses were not recognized until the related loan was sold. Prior to January 1, 2008, guidance also prohibited including the value of servicing the loan in calculating the fair value of an IRLC. Such guidance was rescinded by Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" ("SAB 109"). Accordingly, with the adoption of SFAS No. 157 and SAB 109 on January 1, 2008, the day one gains and servicing value, adjusted by the loan funding probability, are included in the value of IRLCs.

The net change in fair value of the IRLCs and related forward delivery contracts for the three and nine months ended September 30, 2008 resulted in gains of $13.9 million and $40.9 million, respectively, which have been recognized in the accompanying consolidated statements of operations. The net change in fair value of the IRLCs and related forward delivery contracts for the three and nine months ended September 30, 2007 resulted in losses of $1.1 million and $1.0 million, respectively, which have been recognized in the accompanying consolidated statements of operations. The significant change year over year is due principally to the inclusion of day one gains and the value of servicing the loans in 2008 associated with the adoption of SFAS No. 157 and SAB 109. Prior to the adoption of SFAS No. 157 and SAB 109, the recognition of such day one gains and servicing value were proscribed and these gains were not recognized until realized through the sale of the related loans. This change in treatment, therefore, is only related to the timing of revenue recognition. The IRLCs are recorded in "Prepaid and other current assets" and/or "Accrued expenses and other current liabilities" in the accompanying consolidated balance sheets. At September 30, 2008, there was $209.4 million of IRLCs notional value outstanding.

Effective January 1, 2008 Tree.com adopted SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure certain financial instruments at fair

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 9 FAIR VALUE MEASUREMENTS (Continued)**

value with the objective of reducing both the complexity in the accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Upon adoption, Tree.com elected to account for loans held for sale originated after January 1, 2008 at fair value. Electing the fair value option allows a better offset of the changes in fair values of the loans and the forward delivery contracts used to economically hedge them without the burden of complying with the requirements for hedge accounting under SFAS No. 133.

Tree.com did not elect the fair value option on loans held for sale originated prior to January 1, 2008 and on loans that were repurchased from investors on or subsequent to that date. As of September 30, 2008, all such loans were impaired and carried at the lower of cost or market value assessed on an individual loan basis. The market value (or fair value) of these impaired loans at September 30, 2008, measured on a non-recurring basis using significant unobservable inputs (Level 3), was $2.7 million. This fair value measurement is management's best estimate of the market value of such loans and considers re-price bids received from the investors prior to repurchase, if applicable, or current bids in the secondary market for similar loans.

During the three and nine months ended September 30, 2008, the change in fair value of loans held for sale for which the fair value option has been elected were losses of $0.7 million and $2.4 million, respectively, and are included as a component of revenue in the accompanying consolidated statements of operations.

The following table presents the difference between the aggregate fair value and the aggregate unpaid principal balance of loans held for sale at September 30, 2008 for which the fair value option has been elected (in thousands):

| | Aggregate Fair Value | Aggregate Unpaid Principal Balance | Difference |
|---|---|---|---|
| Loans held for sale | $ 63,258 | $ 62,345 | $ 913 |

For the nine months ended September 30, 2008 and 2007, LendingTree Loans sold approximately 8,800 and 32,000 loans, respectively, with initial loan values of $1.7 billion and $5.2 billion, respectively. LendingTree Loans has not experienced any losses from loans sold during the nine months ended September 30, 2008. LendingTree Loans experienced losses of $2.2 million from loans sold during the nine months ended September 30, 2007, which represent 0.042% of the initial loan value of the total loans sold during the nine months ended September 30, 2007.

LendingTree Loans sells loans it originates to investors on a servicing released basis so the risk of loss or default by the borrower is generally transferred to the investor. However, LendingTree Loans is required by these investors to make certain representations relating to credit information, loan documentation and collateral. To the extent LendingTree Loans does not comply with such representations, or there are early payment defaults, LendingTree Loans may be required to repurchase loans or indemnify the investors for any losses from borrower defaults. As such, LendingTree Loans records a liability for the estimated obligation related to this exposure based, in part, on historical and projected loss frequency and loss severity, the original principal amount of the loans previously sold, the year the loans were sold, and loan type. There are four loan types used in this analysis which are determined based on the extent of the documentation received (full or limited) and the lien position of the mortgage in the underling property (first or second position). In the case of early payment payoffs,

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 9 FAIR VALUE MEASUREMENTS (Continued)**

which occurs when a borrower prepays a loan prior to the end of the prepayment penalty period, LendingTree Loans may be required to repay all or a portion of the premium initially paid by the investor. The estimated obligation associated with early loan payoffs is calculated based on historical loss experience by type of loan. Specific circumstances may also cause management to estimate and record additional liabilities specific to a situation based on certain assumptions of future losses as a result of current activity. Because LendingTree Loans does not service the loans it sells, it does not maintain nor have access to the current balances and loan performance data with respect to the individual loans previously sold to investors. As such, LendingTree Loans is unable to determine its maximum loss exposure. For the nine months ended September 30, 2008 LendingTree Loans increased its liability for losses on previously sold loans by approximately $0.9 million as a reduction to revenue and $3.7 million was paid or written off against the liability. The related liability at September 30, 2008 is $11.1 million. For the nine months ended September 30, 2007 LendingTree Loans increased its liability for losses on previously sold loans by approximately $8.3 million as a reduction to revenue and $4.0 million was paid or written off against the liability.

A summary of the initial unpaid principal balance of loans sold by type of loan for the three and nine months ended September 30, 2008 and 2007 and the loans held for sale as of the periods then ended is presented below:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | | 2007 | | 2008 | | 2007 | |
| **Loans Sold** | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** |
| | ($ amounts in millions) | | | | | | | |
| Conforming | $ 388 | 77% | $ 965 | 75% | $1,448 | 83% | $3,453 | 66% |
| FHA/Alt-A | 114 | 23% | 259 | 20% | 300 | 17% | 1,244 | 24% |
| Subprime | | | | | | | 51 | 1% |
| Home equity | 1 | | 66 | 5% | 1 | | 486 | 9% |
| **Total** | $ 503 | 100% | $1,290 | 100% | $1,749 | 100% | $5,234 | 100% |

| | As of September 30, 2008 | | As of December 31, 2007 | |
|---|---|---|---|---|
| **Loans Held For Sale** | **Amount** | **%** | **Amount** | **%** |
| | ($ amounts in thousands) | | | |
| Conforming | $47,054 | 68% | $75,613 | 82% |
| FHA/Alt-A | 17,150 | 25% | 9,658 | 11% |
| Subprime | 2,182 | 3% | 2,456 | 3% |
| Home equity | 3,051 | 4% | 4,241 | 4% |
| **Total** | 69,437 | 100% | 91,968 | 100% |
| Lower of cost or market valuation allowance and fair value adjustments | (3,527) | | (5,214) | |
| **Loans held for sale on the consolidated balance sheet** | $65,910 | | $86,754 | |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 10 INCOME TAXES**

Tree.com calculates its interim income tax provision in accordance with Accounting Principles Board Opinion No. 28 and FASB Interpretation No. 18. At the end of each interim period, Tree.com makes its best estimate of the annual expected effective tax rate and applies that rate to its ordinary year-to-date earnings or loss. The tax or benefit related to significant, unusual, or extraordinary items that will be separately reported or reported net of their related tax effect are individually computed and recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws or rates, tax status, or judgment on the realizability of a beginning-of-the-year deferred tax asset in future years is recognized in the interim period in which the change occurs.

The computation of the annual expected effective tax rate at each interim period requires certain estimates and assumptions including, but not limited to, the expected operating income for the year, permanent and temporary differences, and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, more experience is acquired, additional information is obtained or the tax environment changes. To the extent that the estimated annual effective tax rate changes during a quarter, the effect of the change on prior quarters is included in tax expense for the current quarter.

For the three and nine months ended September 30, 2008, Tree.com recorded a tax benefit of $0.1 million and $13.9 million, respectively, which represents effective tax rates of 0.3% and 7%, respectively. These tax rates are lower than the federal statutory rate of 35% due principally to non-deductible impairment charges and an increase in valuation allowance on deferred tax assets. For the three and nine months ended September 30, 2007 Tree.com recorded a tax benefit of $5.5 million and $13.3 million, respectively, which represents effective tax rates of 47% and 41%, respectively. These tax benefits are higher than the federal statutory rate of 35% due principally to state taxes.

As of December 31, 2007 and September 30, 2008, Tree.com had unrecognized tax benefits of approximately $4.4 million and $2.4 million, respectively. Included in unrecognized tax benefits at September 30, 2008 is approximately $1.7 million for tax positions included in IAC's consolidated tax return filings that remain a liability of IAC after the spin-off. Tree.com recognizes interest and, if applicable, penalties related to unrecognized tax benefits in income tax expense. There were no material accruals for interest for the nine months ended September 30, 2008. At September 30, 2008 Tree.com had accrued $0.5 million for the payment of interest, of which $0.4 million is indemnified by IAC. There are no material accruals for penalties.

By virtue of previously filed separate company and consolidated tax returns with IAC, Tree.com is routinely under audit by federal, state, local and foreign authorities in the area of income tax. These audits include questioning the timing and the amount of deductions and the allocation of income among various tax jurisdictions. Income taxes payable include amounts considered sufficient to pay assessments that may result from examination of prior year returns; however, the amount paid upon resolution of issues raised may differ from the amount provided. Differences between the reserves for tax contingencies and the amounts owed by Tree.com are recorded in the period they become known.

The Internal Revenue Service is currently examining the IAC consolidated tax returns for the years ended December 31, 2001 through 2003, which includes the operations of Tree.com from August 8, 2003, the date on which Tree.com joined the IAC consolidated tax return. The statute of limitations for these years has been extended to December 31, 2009. Various IAC consolidated state, local and foreign jurisdictions are currently under examination, the most significant of which are California, Florida, New

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 10 INCOME TAXES (Continued)**

York state and New York City, for various tax years after December 31, 2001, and these examinations are expected to be completed by the end of 2008.

Tree.com believes that it is reasonably possible that its unrecognized tax benefits could decrease by approximately $0.7 million within twelve months of the current reporting date due to the reversal of deductible temporary differences which will result in a corresponding increase in net deferred tax liabilities. An estimate of other changes in unrecognized tax benefits cannot be made, but are not expected to be significant.

**NOTE 11 CONTINGENCIES**

HLC is party to various employment related lawsuits. During 2006, Tree.com established a reserve of $0.4 million for certain of these actions. During 2008 and 2007, additional reserves of $1.1 million and $2.1 million, respectively, were recorded. The balance of the related liability was $3.6 million at September 30, 2008.

In the ordinary course of business, Tree.com is a party to various lawsuits. Tree.com establishes reserves for specific legal matters when it determines that the likelihood of an unfavorable outcome is probable and the loss is reasonably estimable. Management has also identified certain other legal matters where it believes an unfavorable outcome is not probable and, therefore, no reserve is established. Although management currently believes that an unfavorable resolution of claims against Tree.com, including claims where an unfavorable outcome is reasonably possible, will not have a material impact on the liquidity, results of operations, or financial condition of Tree.com, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. It is possible that an unfavorable outcome of one or more of these lawsuits could have a material impact on the liquidity, results of operations, or financial condition of Tree.com. Tree.com also evaluates other contingent matters, including tax contingencies, to assess the probability and estimated extent of potential loss. See Note 10 for a discussion related to income tax contingencies.

**NOTE 12 RELATED PARTY TRANSACTIONS**

While affiliated with IAC, Tree.com's expenses included allocations from IAC of costs associated with IAC's accounting, treasury, legal, tax, corporate support, human resources and internal audit functions. These expenses were allocated based on the ratio of Tree.com's revenue as a percentage of IAC's total revenue. Allocated costs were $-0- and $0.2 million for the three months ended September 30, 2008 and 2007, respectively, and $0.3 million and $0.8 million for the nine months ended September 30, 2008 and 2007, respectively, and are included in "General and administrative expense" in the accompanying consolidated statements of operations. It is not practicable to determine the amounts of these expenses that would have been incurred had Tree.com operated as an unaffiliated entity. In the opinion of management, the allocation method was reasonable.

**Relationship Between Tree.com and IAC after the Spin-Off**

For purposes of governing certain of the ongoing relationships between Tree.com and IAC at and after the spin-off, and to provide for an orderly transition, Tree.com and IAC entered into a separation agreement, a tax sharing agreement, an employee matters agreement and a transition services agreement (the "Spin-Off Agreements"), among other agreements.

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 13 RESTRUCTURING CHARGES**

The restructuring charges primarily relate to Tree.com's significant reduction in its mortgage origination operations in response to the adverse developments in mortgage market conditions. Costs that relate to ongoing operations are not part of restructuring charges. Restructuring charges by segment and type are as follows (in thousands):

| | For The Three Months Ended September 30, 2008 | | | | |
|---|---|---|---|---|---|
| | Employee Termination Costs | Continuing Lease Obligations | Asset Write-offs | Other | Total |
| Lending | $ 327 | $ 1,429 | $ 646 | $ 20 | $ 2,422 |
| Real Estate | 3 | | | (31) | (28) |
| Total | $ 330 | $ 1,429 | $ 646 | $ (11) | $ 2,394 |

| | For The Nine Months Ended September 30, 2008 | | | | |
|---|---|---|---|---|---|
| | Employee Termination Costs | Continuing Lease Obligations | Asset Write-offs | Other | Total |
| Lending | $ 1,586 | $ 1,494 | $ 984 | $ 8 | $ 4,072 |
| Real Estate | 371 | | 34 | 80 | 485 |
| Total | $ 1,957 | $ 1,494 | $ 1,018 | $ 88 | $ 4,557 |

| | For The Three Months Ended September 30, 2007 | | | | |
|---|---|---|---|---|---|
| | Employee Termination Costs | Continuing Lease Obligations | Asset Write-offs | Other | Total |
| Lending | $ 2,890 | $ 1,839 | $ 1,826 | $ | $ 6,555 |
| Real Estate | | | (154) | | (154) |
| Total | $ 2,890 | $ 1,839 | $ 1,672 | $ | $ 6,401 |

| | For The Nine Months Ended September 30, 2007 | | | | |
|---|---|---|---|---|---|
| | Employee Termination Costs | Continuing Lease Obligations | Asset Write-offs | Other | Total |
| Lending | $ 5,564 | $ 2,753 | $ 2,001 | $ | $ 10,318 |
| Real Estate | 200 | | 481 | | 681 |
| Total | $ 5,764 | $ 2,753 | $ 2,482 | | $ 10,999 |

**TREE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 13 RESTRUCTURING CHARGES (Continued)**

Restructuring charges and spending against liabilities are as follows (in thousands):

| | For The Nine Months Ended September 30, 2008 | | | | |
|---|---|---|---|---|---|
| | Employee Termination Costs | Continuing Lease Obligations | Asset Write-offs | Other | Total |
| Balance, beginning of period | $ 2,064 | $ 3,885 | $ | $ 554 | $ 6,503 |
| Restructuring charges | 1,957 | 1,494 | 1,018 | 88 | 4,557 |
| Payments | (3,182) | (2,005) | | (562) | (5,749) |
| Write-offs | | (74) | (1,018) | (21) | (1,113) |
| Balance, end of period | $ 839 | $ 3,300 | $ | $ 59 | $ 4,198 |

At September 30, 2008, restructuring liabilities of $3.5 million are included in "Accrued expenses and other current liabilities" and $0.7 million are included in "Other long-term liabilities" in the accompanying consolidated balance sheet. At December 31, 2007, restructuring liabilities of $5.6 million are included in "Accrued expenses and other current liabilities" and $0.9 million are included in "Other long-term liabilities" in the accompanying consolidated balance sheet. Tree.com does not expect to incur significant additional costs related to the prior restructurings noted above.

**Item 2.** ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

**Management Overview**

On August 20, 2008, Tree.com, Inc. ("Tree.com") was spun off from its parent company, IAC/InterActiveCorp ("IAC") into a separate publicly traded company. In these consolidated financial statements, we refer to the separation transaction as the "spin-off." In connection with the spin-off, Tree.com was incorporated as a Delaware corporation in April 2008. Tree.com consists of the businesses that formerly comprised IAC's Lending and Real Estate segments. We refer herein to these businesses as the "Tree.com Businesses," which include LendingTree.com, RealEstate.com, GetSmart.com, Home Loan Center, Inc. (d/b/a LendingTree Loans) and iNest.com.

Tree.com's Lending segment consists of online networks (principally LendingTree.com and GetSmart.com) and call centers that connect consumers and financial providers in the lending industry (the "lending networks"). Tree.com also originates, processes, approves and funds various residential real estate loans through Home Loan Center, Inc., which does business as LendingTree Loans in certain jurisdictions. The Home Loan Center, Inc. and LendingTree Loans brand names are collectively referred to in this report as "LendingTree Loans."

Tree.com's Real Estate segment primarily consists of a proprietary full-service real estate brokerage (RealEstate.com, REALTORS®) that operates in fourteen U.S. markets, as well as an online network accessed at *www.RealEstate.com*, that connects consumers with real estate brokerages around the country and iNest.com, an online network that matches buyers and builders of new homes.

***Results of operations for the three and nine months ended September 30, 2008 compared to the three and nine months ended September 30, 2007:***

***Revenue***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending: | | | |
| Origination and sale of loans | $17,911 | (20)% | $22,418 |
| Match fees | 12,120 | (36)% | 19,076 |
| Closed loan fees | 8,196 | (47)% | 15,566 |
| Other lending | 2,250 | (45)% | 4,108 |
| Total Lending | 40,477 | (34)% | 61,168 |
| Real Estate | 9,781 | (29)% | 13,785 |
| Total revenue | $50,258 | (33)% | $74,953 |

Lending revenue in 2008 decreased $20.7 million, or 34%, from the same period in 2007. Revenue generated from the origination and sale of loans in the secondary market declined $4.5 million, or 20%, primarily due to decreases in the available supply of suitable loan products for a broad variety of consumer credit categories as well as lower consumer demand resulting in fewer loans being originated and sold into the secondary market as well as a market driven shift to lower margin conforming loans as compared to the prior year. Revenue from other lending services declined $16.2 million, or 42%, due primarily to fewer consumer loan requests transmitted to and loans closed on the lending networks.

The dollar value of loans closed by network lenders and directly by LendingTree Loans in 2008 decreased 55% to $3.5 billion. This includes refinance mortgages of $1.7 billion, purchase mortgages of $1.3 billion and home equity loans of $0.3 billion. The dollar value of loans closed by network lenders and directly by LendingTree Loans in 2007 was $7.7 billion, including refinance mortgages of $4.0 billion, purchase mortgages of $2.2 billion and home equity loans of $1.2 billion. Revenue from all home loan offerings declined with home equity loans, refinance mortgage and purchase mortgage revenue declining 72%, 32% and 27%, respectively.

LendingTree Loans originates mortgage loans on property located throughout the United States, with no one location representing more than 10% of Tree.com's consolidated revenue for any periods presented. Revenue from loans originated for property in California and Florida in the aggregate totaled approximately 6% and 7% of Tree.com's consolidated revenue for the three months ended September 30, 2008 and 2007, respectively.

Real Estate revenue decreased $4.0 million, or 29%, principally due to a $4.1 million decrease related to the Real Estate builder and broker networks, which experienced decreased closings year over year, as well as a decrease of $1.6 million due to the absence of revenue from the agent network business which ceased operations in December 2007. Partially offsetting the revenue decrease was an increase of $1.6 million in revenue from Tree.com's company owned real estate brokerage business, which increased closings by 51%. The company-owned brokerage business operates in fourteen markets in 2008, compared to ten markets in 2007, and has approximately 1,000 agents in 2008, compared to approximately 600 agents in 2007.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | **2008** | **% Change** | **2007** |
| | | **(Dollars in thousands)** | |
| Lending: | | | |
| Origination and sale of loans | $ 68,739 | (41)% | $ 116,385 |
| Match fees | 45,780 | (30)% | 65,283 |
| Closed loan fees | 29,092 | (46)% | 54,219 |
| Other lending | 8,445 | (51)% | 17,330 |
| Total Lending | 152,056 | (40)% | 253,217 |
| Real Estate | 28,378 | (33)% | 42,374 |
| Total revenue | $ 180,434 | (39)% | $ 295,591 |

Lending revenue in 2008 decreased $101.2 million, or 40%, from the same period in 2007. Revenue generated from the origination and sale of loans in the secondary market declined $47.6 million, or 41%, primarily due to decreases in the available supply of suitable loan products for a broad variety of consumer credit categories as well as lower consumer demand resulting in fewer loans being originated and sold into the secondary market as well as a market driven shift to lower margin conforming loans as compared to the prior year. Revenue from other lending services declined $53.5 million, or 39%, due primarily to fewer consumer loan requests transmitted to and loans closed on the lending networks.

The dollar value of loans closed by network lenders and directly by LendingTree Loans in 2008 decreased 48% to $7.8 billion. This includes refinance mortgages of $4.2 billion, purchase mortgages of $2.6 billion and home equity loans of $0.8 billion. The dollar value of loans closed by network lenders and directly by LendingTree Loans in 2007 was $15.0 billion, including refinance mortgages of $8.1 billion, purchase mortgages of $4.0 billion and home equity loans of $2.5 billion. Revenue from all home loan offerings declined with home equity loans, purchase mortgage revenue and refinance mortgage revenue declining 74%, 36% and 32%, respectively.

Lending Tree Loans originates mortgage loans on property located throughout the United States, with no one location representing more than 10% of Tree.com's consolidated revenue for any periods presented. Revenue from loans originated for property in California and Florida in the aggregate totaled approximately 7% and 10% of Tree.com's consolidated revenue for the nine months ended September 30, 2008 and 2007, respectively.

Real Estate revenue decreased $14.0 million, or 33%, principally due to a decrease of $12.2 million related to the Real Estate builder and broker networks, which experienced decreased closings year over year, as well as a decrease of $5.9 million due to the absence of revenue from the agent network business which ceased operations in December 2007. Partially offsetting the revenue decrease was an increase of $3.9 million in revenue from Tree.com's company-owned real estate brokerage business, which increased closings by 41%.

***Cost of revenue***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $ 9,895 | (12)% | $ 11,271 |
| Real Estate | 5,883 | (16)% | 7,008 |
| Cost of revenue | $ 15,778 | (14)% | $ 18,279 |
| As a percentage of total revenue | 31% | | 24% |
| Gross margin % | 69% | | 76% |

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Cost of revenue Lending | $ 9,895 | (12)% | $ 11,271 |
| As a percentage of Lending revenue | 24% | | 18% |
| Lending gross margin | 76% | | 82% |
| Cost of revenue Real Estate | $ 5,883 | (16)% | $ 7,008 |
| As a percentage of Real Estate revenue | 60% | | 51% |
| Real Estate gross margin | 40% | | 49% |

Cost of revenue consists primarily of costs associated with loan originations, compensation and other employee-related costs (including stock-based compensation) related to customer call centers and real estate network support staff, as well as credit scoring fees, consumer incentive costs, real estate agent commissions and website network hosting and server fees.

Cost of revenue in 2008 decreased $2.5 million from 2007 primarily due to decreases of $2.0 million in consumer incentive rebates related to decreased closings at the Lending network and the Real Estate builder and broker network businesses, $1.3 million in compensation and other employee-related costs (net of an increase of $0.5 million in non-cash compensation) and $0.8 million in direct costs associated with the settlement services business. The decrease in compensation and other employee-related costs is primarily due to reduced personnel costs associated with Tree.com's customer call center, settlement services operation and portions of its loan processing department.

Offsetting these decreases in cost of revenue was an increase of $1.2 million in costs associated with loan originations. This increase in 2008 is related to the impact of Tree.com's adoption of Statement of Financial Accounting Standards ("SFAS") No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" ("SFAS 159"). Upon adoption of SFAS 159, Tree.com elected to account for all loans held for sale originated after January 1, 2008 at fair value. Electing the fair value option requires loan origination fees and costs to be recorded in earnings as incurred instead of being deferred until the loan is sold as in prior year periods. In 2008, all loan origination costs are recognized in cost of revenue. Prior to 2008, Tree.com applied the provisions of SFAS 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases", effectively deferring loan origination fees and costs until the underlying loan was sold. Upon sale of the loan, the origination fees and costs were recognized as a component of the gain on sale of the loan in revenue.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $34,096 | (12)% | $38,915 |
| Real Estate | 16,823 | (19)% | 20,802 |
| Cost of revenue | $50,919 | (15)% | $59,717 |
| As a percentage of total revenue | 28% | | 20% |
| Gross margin | 72% | | 80% |

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Cost of revenue Lending | $34,096 | (12)% | $38,915 |
| As a percentage of Lending revenue | 22% | | 15% |
| Lending gross margin | 78% | | 85% |
| Cost of revenue Real Estate | $16,823 | (19)% | $20,802 |
| As a percentage of Real Estate revenue | 59% | | 49% |
| Real Estate gross margin | 41% | | 51% |

Cost of revenue in 2008 decreased $8.8 million from 2007 primarily due to decreases of $5.4 million in consumer incentive rebates related to decreased closings at the Lending network and the Real Estate builder and broker network businesses, $4.1 million in compensation and other employee-related costs (net of an increase of $0.5 million in non-cash compensation), $2.9 million in direct costs associated with the settlement services business, and $1.2 million in credit scoring and licenses. Offsetting these decreases in cost of revenue were increases of $3.8 million in costs associated with loan originations and $1.8 million in commission expense primarily related to the increase in closings at the company-owned brokerage business. The decrease in compensation and other employee-related costs is primarily due to the factors described above in the three month discussion.

Included in cost of revenue in 2008 is the impact of Tree.com's adoption of SFAS 159 as described above in the three month discussion.

***Selling and marketing expense***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $24,214 | (37)% | $38,616 |
| Real Estate | 1,778 | (65)% | 5,139 |
| Selling and marketing expense | $25,992 | (41)% | $43,755 |
| As a percentage of total revenue | 52% | | 58% |

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Selling and marketing expense Lending | $24,214 | (37)% | $38,616 |
| As a percentage of Lending revenue | 60% | | 63% |
| Selling and marketing expense Real Estate | $ 1,778 | (65)% | $ 5,139 |
| As a percentage of Real Estate revenue | 18% | | 37% |

Selling and marketing expense consists primarily of advertising and promotional expenditures, fees paid to lead sources and compensation and other employee-related costs (including stock-based compensation) for personnel engaged in the sales function and loan officers. Advertising and promotional expenditures primarily include online marketing, as well as television, print and radio spending. Advertising production costs are expensed in the period the related ad is first run.

Selling and marketing expense in 2008 decreased $17.8 million from 2007 primarily due to a decrease of $17.4 million in advertising and promotional expenditures. In 2008, Tree.com decreased its spending in advertising of $11.4 million, $1.3 million and $2.9 million associated with online marketing, print and broadcast advertising, respectively. Tree.com anticipates that it will continue to adjust selling and marketing expenditures generally in relation to revenue producing opportunities and that selling and marketing will continue to represent a high percentage of revenue as it continues to promote its brands both online and offline.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $84,354 | (40)% | $140,446 |
| Real Estate | 6,118 | (63)% | 16,639 |
| Selling and marketing expense | $90,472 | (42)% | $157,085 |
| As a percentage of total revenue | 50% | | 53% |

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Selling and marketing expense Lending | $84,354 | (40)% | $140,446 |
| As a percentage of Lending revenue | 55% | | 55% |
| Selling and marketing expense Real Estate | $ 6,118 | (63)% | $ 16,639 |
| As a percentage of Real Estate revenue | 22% | | 39% |

Selling and marketing expense in 2008 decreased $66.6 million from 2007 primarily due to a decrease of $67.1 million in advertising and promotional expenditures. In 2008, Tree.com adjusted its spending in line with revenue producing opportunities, resulting in decreases in advertising costs of $39.8 million, $11.7 million and $10.8 million associated with online marketing, print and broadcast advertising, respectively.

***General and administrative expense***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | **2008** | **% Change** | **2007** |
| | **(Dollars in thousands)** | | |
| Lending | $ 16,687 | (12)% | $ 18,887 |
| Real Estate | 6,088 | 42% | 4,279 |
| General and administrative expense | $ 22,775 | (2)% | $ 23,166 |
| As a percentage of total revenue | 45% | | 31% |

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | **2008** | **% Change** | **2007** |
| | **(Dollars in thousands)** | | |
| General and administrative expense Lending | $ 16,687 | (12)% | $ 18,887 |
| As a percentage of Lending revenue | 41% | | 31% |
| General and administrative expense Real Estate | $ 6,088 | 42% | $ 4,279 |
| As a percentage of Real Estate revenue | 62% | | 31% |

General and administrative expense consists primarily of compensation and other employee-related costs (including stock-based compensation) for personnel engaged in finance, legal, tax, corporate IT, human resources and executive management functions, as well as facilities and infrastructure costs and fees for professional services.

General and administrative expense in 2008 decreased $0.4 million from 2007. Compensation and other employee-related costs, excluding non-cash compensation, decreased $4.2 million as a result of restructuring activities. Non-cash compensation expense was $6.5 million in 2008 compared with $0.3 million in 2007. Non-cash compensation in 2008 includes a $5.5 million charge due to the modification of equity-based awards related to the spin-off, which consists of the accelerated vesting of certain restricted stock units and the modification of vested stock options.

Other significant decreases during 2008 include $1.3 million in litigation expense, $0.6 million in facilities costs and $0.4 million in bad debt expense.

The increase in general and administrative expense for Real Estate is due to an increase in non-cash compensation of $2.1 million, primarily due to the modification of equity-based awards noted above.

As of September 30, 2008, there was approximately $10.9 million of unrecognized compensation cost, net of estimated forfeitures, related to all equity-based awards, which is currently expected to be recognized over a weighted average period of approximately 2.8 years.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | **2008** | **% Change** | **2007** |
| | (Dollars in thousands) | | |
| Lending | $ 43,612 | (33)% | $ 64,859 |
| Real Estate | 15,036 | (5)% | 15,867 |
| General and administrative expense | $ 58,648 | (27)% | $ 80,726 |
| As a percentage of total revenue | 33% | | 27% |

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | **2008** | **% Change** | **2007** |
| | (Dollars in thousands) | | |
| General and administrative expense Lending | $ 43,612 | (33)% | $ 64,859 |
| As a percentage of Lending revenue | 29% | | 26% |
| General and administrative expense Real Estate | $ 15,036 | (5)% | $ 15,867 |
| As a percentage of Real Estate revenue | 53% | | 37% |

General and administrative expense in 2008 decreased $22.1 million from 2007. As a result of restructuring activities that occurred during and subsequent to the second quarter of 2007, compensation and other employee-related costs, excluding non-cash compensation, decreased $17.7 million and facilities costs decreased $2.6 million. Also contributing to the decrease in general and administrative expense are decreases of $2.8 million in litigation expense and $1.4 million in bad debt expense, partially offset by a charge of $1.0 million associated with legal and regulatory costs.

General and administrative expense includes non-cash compensation expense of $8.4 million in 2008 compared with $2.4 million in 2007. Non-cash compensation expense in 2008 includes a $5.5 million charge due to the modification of equity-based awards related to the spin-off, which consists of the accelerated vesting of certain restricted stock units and the modification of vested stock options.

The modest overall decrease in general and administrative expense for Real Estate is net of a $2.0 million increase in non-cash compensation, primarily due to the modification of equity-based awards noted above.

***Product development***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | **2008** | **% Change** | **2007** |
| | (Dollars in thousands) | | |
| Lending | $ 1,286 | (48)% | $ 2,494 |
| Real Estate | 493 | (63)% | 1,350 |
| Product development | $ 1,779 | (54)% | $ 3,844 |
| As a percentage of total revenue | 4% | | 5% |

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Product development Lending | $ 1,286 | (48)% | $ 2,494 |
| As a percentage of Lending revenue | 3% | | 4% |
| Product development Real Estate | $ 493 | (63)% | $ 1,350 |
| As a percentage of Real Estate revenue | 5% | | 10% |

Product development expense consists primarily of compensation and other employee-related costs (including stock-based compensation) for personnel engaged in product development, which include costs related to the design, development, testing and enhancement of technology that are not capitalized.

Product development expense in 2008 decreased $2.1 million from 2007, due to decreased compensation and other employee-related costs associated with reductions in workforce that occurred during and subsequent to the second quarter of 2007.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $ 3,572 | (53)% | $ 7,669 |
| Real Estate | 1,759 | (59)% | 4,341 |
| Product development | $ 5,331 | (56)% | $ 12,010 |
| As a percentage of total revenue | 3% | | 4% |

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Product development Lending | $ 3,572 | (53)% | $ 7,669 |
| As a percentage of Lending revenue | 2% | | 3% |
| Product development Real Estate | $ 1,759 | (59)% | $ 4,341 |
| As a percentage of Real Estate revenue | 6% | | 10% |

Product development expense in 2008 decreased $6.7 million from 2007, driven by the factors described above in the three month discussion.

***Restructuring expense***

*For the three and nine months ended September 30, 2008 compared to the three and nine months ended September 30, 2007*

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2008 | % Change | 2007 | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | | | | |
| Lending | $2,422 | (63)% | $6,555 | $4,072 | (61)% | $10,318 |
| Real Estate | (28) | (81)% | (154) | 485 | (29)% | 681 |
| Restructuring expense | $2,394 | (63)% | $6,401 | $4,557 | (59)% | $10,999 |
| As a percentage of total revenue | 5% | | 9% | 3% | | 4% |

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2008 | % Change | 2007 | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | | | | |
| Restructuring expense Lending | $2,422 | (63)% | $6,555 | $4,072 | (61)% | $10,318 |
| As a percentage of Lending revenue | 6% | | 11% | 3% | | 4% |
| Restructuring expense Real Estate | $ (28) | (81)% | $ (154) | $ 485 | (29)% | $ 681 |
| As a percentage of Real Estate revenue | NM | | NM | 2% | | 2% |

In response to adverse developments in mortgage market conditions, Tree.com recorded restructuring expense of $2.4 million and $4.6 million for the three and nine months ended September 30, 2008 compared to $6.4 million and $11.0 million for the three and nine months ended September 30, 2007. The restructuring expense for the nine months ended September 30, 2008 includes $2.0 million in employee termination costs associated with reductions in workforce, $1.5 million for liabilities associated with exiting facilities previously used by LendingTree Loans and $1.0 million for write-offs of fixed assets. The restructuring expense for the nine months ended September 30, 2007 includes $5.8 million in employee termination costs associated with reductions in workforce, $2.8 million for liabilities associated with exiting facilities previously used by LendingTree Loans and $2.5 million for write-offs of fixed assets. As a part of these restructurings, positions across all departments and locations of Tree.com's business were eliminated, however the Lending restructuring expenses principally related to the mortgage origination operations of LendingTree Loans.

***Earnings Before Interest, Taxes, Deprecation and Amortization***

Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") is a non-GAAP measure and is defined in "Tree.com's Principles of Financial Reporting".

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $ (8,938) | (552)% | $ (1,372) |
| Real Estate | (1,717) | 53% | (3,647) |
| EBITDA | $ (10,655) | (112)% | $ (5,019) |
| As a percentage of total revenue | (21)% | | (7)% |

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| EBITDA Lending | $ (8,938) | (552)% | $ (1,372) |
| As a percentage of Lending revenue | (22)% | | (2)% |
| EBITDA Real Estate | $ (1,717) | 53% | $ (3,647) |
| As a percentage of Real Estate revenue | (18)% | | (26)% |

EBITDA loss in 2008 increased $5.6 million to $10.7 million. However, 2007 EBITDA reflects $15.0 million of proceeds from a litigation settlement, which are shown as a reduction in operating expenses. In 2007, EBITDA loss was further impacted by a $7.8 million provision for loan losses. Adjusting for the litigation proceeds, EBITDA improved $9.4 million in 2008, reflecting costs decreasing more rapidly than revenue in 2008 principally due to the marketing reductions and restructuring activities noted above.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $ (11,059) | NM | $ 7,926 |
| Real Estate | (8,410) | 44% | (14,920) |
| EBITDA | $ (19,469) | (178)% | $ (6,994) |
| As a percentage of total revenue | (11)% | | (2)% |

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| EBITDA Lending | $ (11,059) | NM | $ 7,926 |
| As a percentage of Lending revenue | (7)% | | 3% |
| EBITDA Real Estate | $ (8,410) | 44% | $ (14,920) |
| As a percentage of Real Estate revenue | (30)% | | (35)% |

EBITDA loss in 2008 increased $12.5 million to $19.5 million. However, 2007 EBITDA reflects $15.0 million of proceeds from a litigation settlement, which are shown as a reduction in operating expenses. EBITDA loss was further impacted by a $1.0 million provision for loan losses in 2008, compared to $11.4 million in 2007. Adjusting for the litigation proceeds, EBITDA improved $2.5 million in 2008, reflecting costs decreasing more rapidly than revenue in 2008 principally due to the marketing reductions and restructuring activities noted above.

***Operating loss***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $ (16,480) | (148)% | $ (6,655) |
| Real Estate | (5,975) | (14)% | (5,261) |
| Operating loss | $ (22,455) | (88)% | $ (11,916) |
| As a percentage of total revenue | (45)% | | (16)% |

| | Three Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Operating loss Lending | $ (16,480) | (148)% | $ (6,655) |
| As a percentage of Lending revenue | (41)% | | (11)% |
| Operating loss Real Estate | $ (5,975) | (14)% | $ (5,261) |
| As a percentage of Real Estate revenue | (61)% | | (38)% |

Operating loss in 2008 increased $10.5 million from 2007 resulting primarily from the issues discussed above.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Lending | $(131,440) | (1,272)% | $ (9,583) |
| Real Estate | (77,257) | (243)% | (22,493) |
| Operating loss | $(208,697) | (551)% | $(32,076) |
| As a percentage of total revenue | (116)% | | (11)% |

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| | 2008 | % Change | 2007 |
| | (Dollars in thousands) | | |
| Operating loss Lending | $(131,440) | (1,272)% | $ (9,583) |
| As a percentage of Lending revenue | (86)% | | (4)% |
| Operating loss Real Estate | $ (77,257) | (243)% | $(22,493) |
| As a percentage of Real Estate revenue | (272)% | | (53)% |

Operating loss in 2008 increased $176.6 million from 2007, resulting primarily from impairment charges of $131.0 million and $33.4 million related to goodwill and an indefinite-lived intangible asset, respectively. The charges associated with Lending were $70.2 million related to goodwill and $33.4 million related to an indefinite-lived intangible asset. The charge related to Real Estate was a goodwill impairment charge of $60.8 million.

These impairments resulted from Tree.com's most recent reassessment of the likely future profitability of Lending and Real Estate in light of the persistent adverse mortgage and real estate market conditions and the operational strategies Tree.com has undertaken in response to these market realities. These adverse conditions include, among others, constrained liquidity, lender focus on low margin conforming loans, uncertainty as to the eventuality and timing of the return of higher margin mortgage offerings, the decline in real estate values and a high rate of delinquency for existing mortgages. Tree.com updated its assessment of mortgage and real estate market conditions and Tree.com's responsive operational strategies during the second quarter of 2008 and quantified these considerations in Tree.com's future forecasted results.

Also contributing to the increase in operating loss was the increase in EBITDA loss described above.

Continued adverse market conditions may give rise to continued operating losses and require additional restructuring of Tree.com's operations and could give rise to additional restructuring charges and additional impairment charges.

***Income tax provision***

*For the three months ended September 30, 2008 compared to the three months ended September 30, 2007*

For the three months ended September 30, 2008 and 2007, Tree.com recorded a tax benefit of $0.1 million and $5.5 million, respectively, which represents effective tax rates of 0.3% and 47%, respectively. The 2008 tax rate is lower than the federal statutory rate of 35% due principally to non-deductible impairment charges and an increase in the valuation allowance on deferred tax assets. The 2007 tax rate is higher than the federal statutory rate of 35% due principally to state taxes.

*For the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007*

For the nine months ended September 30, 2008 and 2007, Tree.com recorded a tax benefit of $13.9 million and $13.3 million, respectively, which represents effective tax rates of 7% and 41%, respectively. The 2008 tax rate is lower than the federal statutory rate of 35% due principally to non-deductible impairment charges and an increase in the valuation allowance on deferred tax assets. The 2007 tax rate is higher than the federal statutory rate of 35% due principally to state taxes.

As of December 31, 2007 and September 30, 2008, Tree.com had unrecognized tax benefits of approximately $4.4 million and $2.4 million, respectively. Included in unrecognized tax benefits at September 30, 2008 is approximately $1.7 million for tax positions included in IAC's consolidated tax return filings that will remain a liability of IAC after the spin-off. Tree.com recognizes interest and, if applicable, penalties related to unrecognized tax benefits in income tax expense. There were no material accruals for interest for the nine months ended September 30, 2008. At September 30, 2008, Tree.com had accrued $0.5 million for the payment of interest, of which $0.4 million is indemnified by IAC. There are no material accruals for penalties.

By virtue of previously filed separate company and consolidated tax returns with IAC, Tree.com is routinely under audit by federal, state and local authorities in the area of income tax. These audits include questioning the timing and the amount of deductions and the allocation of income among various tax jurisdictions. Income taxes payable include amounts considered sufficient to pay assessments that may result from examination of prior year returns; however, the amount paid upon resolution of issues raised may differ from the amount provided. Differences between the reserves for tax contingencies and the amounts owed by Tree.com are recorded in the period they become known. Tree.com believes that it is reasonably possible that its unrecognized tax benefits could decrease by approximately $0.7 million within twelve months of the current reporting date due to the reversal of deductible temporary differences which will result in a corresponding increase in net deferred tax liabilities. An estimate of other changes in unrecognized tax benefits cannot be made, but are not expected to be significant.

Under the terms of the tax sharing agreement, which was executed in connection with the spin-off, IAC generally retains the liability related to federal and state returns filed on a consolidated or unitary basis for all periods prior to the spin-off.

**FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2008, Tree.com had $98.2 million of cash and cash equivalents and restricted cash and cash equivalents.

Net cash used in operating activities was $11.8 million in the nine months ended September 30, 2008, compared to net cash provided by operating activities of $195.1 million in the same period in 2007. The decrease of $206.9 million is primarily due to a $181.3 million decrease in net proceeds and gains from the sales of loans held for sale.

Net cash used in investing activities in the nine months ended September 30, 2008 of $18.0 million primarily resulted from the payment of contingent consideration associated with the Home Loan Center, Inc. acquisition of $14.5 million and capital expenditures of $3.3 million. Net cash used in investing activities in the same period in 2007 of $8.5 million resulted from the payment of contingent consideration associated with the iNest acquisition of $1.0 million and capital expenditures of $7.5 million.

Net cash provided by financing activities in 2008 of $66.3 million was primarily due to capital contributions of $109.4 million from IAC in connection with the spin-off, partially offset by payments on notes payable and capital lease obligations of $20.0 million and net repayments of warehouse lines of credit of $22.6 million. Net cash used in financing activities in 2007 of $229.9 million was primarily due to net payments under warehouse lines of credit of $194.5 and payments on notes payable and capital lease obligations of $11.3 million. The net payments under warehouse lines of credit in 2008 and 2007 is related to the decrease in loans held for sale at LendingTree Loans and is included within cash flow from operations.

As of September 30, 2008, LendingTree Loans had committed lines of credit totaling $100 million, of which $50 million was scheduled to expire on October 31, 2008, and another $50 million expires on January 24, 2009, and an uncommitted line of credit of $150 million. The $50 million committed line of credit that expires on January 24, 2009 and the $150 million uncommitted line are provided by the same lender. The $50 million committed line that was scheduled to expire on October 31, 2008 has been extended for 60 days. Both parties continue to work on renewal of the line and anticipate having the final terms agreed to prior to the end of the extension on December 30, 2008. The $50 million committed line of credit that expires on January 24, 2009 can be cancelled at the option of the lender without default upon sixty days notice. However, if the lender determines at any time prior to January 24, 2009 that the spin-off materially and adversely affects LendingTree Loans, the lender reserves the right to deem the line of credit expired prior to January 24, 2009. Under the terms of the committed lines of credit, LendingTree Loans is required to maintain various financial and other covenants. These financial covenants include, but are not limited to, maintaining (i) minimum levels of tangible net worth, cash on hand with a certain lender and liquid assets, (ii) a maximum ratio of total liabilities to net worth and (iii) positive pre-tax net income on a quarterly basis. During the three months ended September 30, 2008, LendingTree Loans was not in compliance with the quarterly positive pre-tax net income covenant. LendingTree Loans received a waiver of this covenant breach on October 28, 2008.

Borrowings under these lines of credit are used to fund, and are secured by, consumer residential loans that are held for sale. Loans under these lines of credit are repaid from proceeds from the sales of loans held for sale by LendingTree Loans. The interest rate under these lines of credit is 30-day LIBOR plus 75 to 140 basis points, but may be higher under certain circumstances. At September 30, 2008, there was $56.8 million outstanding under the committed lines of credit. Borrowings under all of LendingTree Loans' lines of credit are non-recourse to Tree.com.

Tree.com anticipates that the $100 million of committed lines of credit are sufficient to fund its current and projected levels of monthly loan origination volume.

Tree.com anticipates that it will need to make capital and other expenditures in connection with the development and expansion of its overall operations.

Tree.com has considered its anticipated operating cash flows in 2008, cash and cash equivalents, current borrowing capacity under lines of credit, its capitalization subsequent to the spin-off and access to capital markets, subject to restrictions in the tax sharing agreement, and believes that these are sufficient to fund its operating needs, including debt requirements, commitments and contingencies and capital and investing commitments for the foreseeable future. In connection with the completion of the spin-off, intercompany payable balances were extinguished and IAC transferred to Tree.com an amount of cash that is sufficient for its initial capitalization. LendingTree Loans is highly dependent on the availability of credit to finance its operations. Its inability to renew or replace existing facilities upon expiration or termination, which could be impacted by continuing disruptions in the credit market, would adversely impact its results of operations and financial condition.

**CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS**

| Contractual Obligations as of September 30, 2008 | Total | Payments Due by Period Less Than 1 Year | 1 3 Years | 3 5 Years | More Than 5 Years |
|---|---|---|---|---|---|
| | | (In thousands) | | | |
| Short-term borrowings | $56,803 | $56,803 | $ | $ | $ |
| Purchase obligations(a) | 719 | 719 | | | |
| Operating leases | 25,259 | 7,452 | 8,206 | 5,447 | 4,154 |
| Total contractual cash obligations | $82,781 | $64,974 | $ 8,206 | $ 5,447 | $ 4,154 |

(a) The purchase obligations primarily relate to marketing contracts in 2008.

**Seasonality**

Lending and Real Estate revenue is subject to the cyclical and seasonal trends of the U.S. housing market. Home sales typically rise during the spring and summer months and decline during the fall and winter months. Refinancing and home equity activity is principally driven by mortgage interest rates as well as real estate values. The broader cyclical trends in the mortgage and real estate markets have upset the usual seasonal trends.

**New Accounting Pronouncements**

Refer to Note 2 to the consolidated financial statements for a description of recent accounting pronouncements.

## TREE.COM'S PRINCIPLES OF FINANCIAL REPORTING

Tree.com reports Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") as a supplemental measure to GAAP. This measure is one of the primary metrics by which Tree.com evaluates the performance of its businesses, on which its internal budgets are based and by which management is compensated. Tree.com believes that investors should have access to the same set of tools that it uses in analyzing its results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, but should not be considered a substitute for or superior to GAAP results. Tree.com provides and encourages investors to examine the reconciling adjustments between the GAAP and non-GAAP measure which are discussed below.

**Definition of Tree.com's Non-GAAP Measures**

EBITDA is defined as operating income excluding, if applicable: (1) depreciation expense, (2) non-cash compensation expense, (3) amortization and impairment of intangibles, (4) goodwill impairment, (5) pro forma adjustments for significant acquisitions, and (6) one-time items. Tree.com believes this measure is useful to investors because it represents the operating results from the Tree.com Businesses, but excludes the effects of these non-cash expenses. EBITDA has certain limitations in that it does not take into account the impact to Tree.com's statement of operations of certain expenses, including depreciation, non-cash compensation, and acquisition-related accounting. Tree.com endeavors to compensate for the limitations of the non-GAAP measure presented by also providing the comparable GAAP measure with equal or greater prominence and descriptions of the reconciling items, including quantifying such items, to derive the non-GAAP measure.

Adjusted EBITDA is defined as EBITDA, which is defined above, excluding (1) restructuring expenses and (2) and proceeds from litigation settlements. Tree.com believes this measure is useful to investors because it represents the operating results from the Tree.com Businesses, but excludes the effects of the expenses. Adjusted EBITDA has certain limitations in that it does not take into account the impact to Tree.com's statement of operations of certain expenses, including depreciation, non-cash compensation, and acquisition-related accounting. Tree.com endeavors to compensate for the limitations of the non-GAAP measure presented by also providing the comparable GAAP measure with equal or greater prominence and descriptions of the reconciling items, including quantifying such items, to derive the non-GAAP measure.

**Pro Forma Results**

Tree.com will only present EBITDA on a pro forma basis if it views a particular transaction as significant in size or transformational in nature. For the periods presented in this report, there are no transactions that Tree.com has included on a pro forma basis.

**One-Time Items**

EBITDA is presented before one-time items, if applicable. These items are truly one-time in nature and non-recurring, infrequent or unusual, and have not occurred in the past two years or are not expected to recur in the next two years, in accordance with SEC rules. For the periods presented in this report, there are no one-time items.

**Non-Cash Expenses That Are Excluded From Tree.com's Non-GAAP Measures**

*Non-cash compensation* expense consists principally of expense associated with the grants, including unvested grants assumed in acquisitions, of restricted stock units and stock options. These expenses are not paid in cash, and Tree.com will include the related shares in its future calculations of fully diluted shares outstanding. Upon vesting of restricted stock units and the exercise of certain stock options, the awards will be settled, at Tree.com's discretion, on a net basis, with Tree.com remitting the required tax withholding amount from its current funds.

*Amortization of intangibles* is a non-cash expense relating primarily to acquisitions. At the time of an acquisition, the intangible assets of the acquired company, such as purchase agreements, technology and customer relationships, are valued and amortized over their estimated lives. Tree.com believes that since intangibles represent costs incurred by the acquired company to build value prior to acquisition, they were part of transaction costs.

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**RECONCILIATION OF EBITDA**

For a reconciliation of EBITDA to operating loss for Tree.com's operating segments and to net loss in total for the three and nine months ended September 30, 2008, see Note 7 to the consolidated financial statements.

**FORWARD-LOOKING STATEMENTS**

Forward-looking statements in this report, the public filings or other public statements of the Company are subject to known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements or other public statements. Forward-looking statements include the information regarding future financial performance, business prospects and strategy, including the completion of the spin-off and the realization of related anticipated benefits, anticipated financial position, liquidity and capital needs and other similar matters, in each case relating to the Company.

Statements preceded by, followed by or that otherwise include the words "believes," "expects," "anticipates," "intends," "projects," "estimates," "plans," "may increase," "may fluctuate," and similar expressions or future or conditional verbs such as "will," "should," "would," "may" and "could" are generally forward-looking in nature and not historical facts. You should understand that the following important factors could affect future results and could cause actual results to differ materially from those expressed in such forward-looking statements:

- adverse changes in economic conditions generally or in any of the markets or industries in which the businesses of the Company operate;
- changes in senior management at the Company;
- adverse changes to, or interruptions in, relationships with third parties;
- changes affecting the ability of the Company to efficiently maintain and grow the market share of its various brands, as well as to extend the reach of these brands through a variety of distribution channels and to attract new (and retain existing) customers;
- changes affecting the ability of the Company to develop, introduce or market new products and services or consumer acceptance of such new products and services offered by the Company;
- the rates of growth of the Internet and the e-commerce industry;
- changes adversely affecting the ability of the Company to adequately expand the reach of its businesses into various international markets, as well as to successfully manage risks specific to international operations and acquisitions, including the successful integration of acquired businesses;
- future regulatory and legislative actions and conditions affecting the Company, including:
  - the promulgation of new, and/or the amendment of existing laws, rules and regulations applicable to the Company and its businesses; and
  - changes in the application or interpretation of existing laws, rules and regulations in the case of the businesses of the Company. In each case, laws, rules and regulations include, among others, those relating to sales, use, value-added and other taxes, software programs, consumer protection and privacy, intellectual property, the Internet and e-commerce;
- competition from other companies;

changes adversely affecting the ability of the Company and its businesses to adequately protect intellectual property rights, as well as to obtain licenses or other rights with respect to intellectual property in the future, which may or may not be available on favorable terms (if at all);

the substantial indebtedness of the Company and the possibility that the Company may incur additional indebtedness;

- third-party claims alleging infringement of intellectual property rights by the Company or its businesses, which could result in the expenditure of significant financial and managerial resources, injunctions or the imposition of damages, as well as the need to enter into formal licensing or other similar arrangements with such third parties, which may or may not be available on favorable terms (if at all); and

- natural disasters, acts of terrorism, war or political instability.

Certain of these factors and other factors, risks and uncertainties are discussed in Part II, Item 1A. Other unknown or unpredictable factors may also cause actual results to differ materially from those projected by the forward-looking statements. Most of these factors are difficult to anticipate and are generally beyond the control of the Company.

You should consider the areas of risk described above, as well as those set forth under Part II, Item 1A in connection with considering any forward-looking statements that may be made by the Company generally. Except for the ongoing obligations of the Company to disclose material information under the federal securities laws, the Company does not undertake any obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events unless required to do so by law.