IAC Q2 2016 Shareholder Letter

July 27, 2016

Dear Shareholders,

We met with a handful of analysts and shareholders this quarter. We try not to spend too much time in these meetings every quarter, away from operating the business, but we learn a lot from the unhappier shareholders because they're unrelenting in their criticism and candor. Fortunately, the happy meetings outnumbered the angry ones this quarter, but the angry ones are generally more helpful in writing these letters. Not surprisingly, critics had two primary demands: they wanted a commitment that we buy more stock and a timeline for the next spinoff. We will provide neither of those things, though we've been clear for a while that we believe both are great tools for delivering shareholder value over time. I will explain our thinking on repurchases below, and merely point to our successful ten year track record on spin-offs, saving a discussion of strategy for a later time.

I also heard some skepticism, which did surprise me, around HomeAdvisor's long-term potential and Vimeo's ability to compete. We have limited real estate in these letters, so in an effort to keep this letter shorter, we'll focus almost entirely on HomeAdvisor this quarter. We'll save Vimeo for next quarter, other than to say we know we need to work hard to show why we believe that Vimeo, as the largest open video marketplace in the world without interruptive advertising, is on a path to take share and grow the multi-hundred billion dollar paid video market. Quarterly letters will continue in this format: we'll cover a particular topic we consider important to shareholders, and once a year we will provide a comprehensive look at all of our segments, as we did last quarter. We will also, of course, continue to provide an opportunity for Q&A with management every quarter to allow for questions on any of our results or expectations and will occasionally invite other executives within IAC to join the call. This quarter, with the focus on HomeAdvisor, CEO Chris Terrill will join.

As for share repurchases: The astute observer will notice that while IAC's stock price rose more than 25% since our last earnings announcement (equating to an increase of approximately $1.1 billion in IAC equity value), Match's stock price rose nearly 50% (equating to an increase of nearly $1.2 billion in the value of our Match stake), such that the implied value of everything in IAC besides Match actually *declined* by about $100 million. Notwithstanding the bargain price of $700 million on average implied for everything in IAC besides our stake in Match and our cash net of debt, we didn't buy any additional stock this quarter. As we've said many times, we believe in our businesses, but our share repurchases are not going to be predictable quarter-to-quarter – nor should they be – and we don't want to get in the habit of defending why we have or have not repurchased shares every 90 days. Nonetheless, our conduct in the last quarter was not due to a lack of conviction on value, but rather a countervailing sense that we are entering a period with increased volatility in public and private markets (Investopedia's Anxiety Index saw its biggest increase all year in June) with a difficult IPO market and a tightening of venture financing, and we want the financial flexibility to seize opportunities that may arise from these conditions. Plus, we've spent a healthy amount on share repurchases since the beginning of the year, amounting to almost 30% of our current net cash and more than double our Adjusted EBITDA this year when excluding Match. I won't speculate on the future, and will only note that we still have over 10 million shares remaining under our current repurchase authorization.

In terms of operating performance, we had another great quarter in our high growth, higher potential businesses and took action to restructure our low-performing businesses. In my experience, we frequently forecast the growing businesses too conservatively on the upside, and the struggling businesses too aggressively relative to the downside. Oddly, we're not optimistic enough when we have reason to be, and too optimistic when we don't. I'd like to say that with pattern recognition we ought to be able to excise this deficiency in our forecasting, but we saw it again this quarter with better than expected performance at Match, HomeAdvisor, and Vimeo, and weaker performance than we'd like in Publishing and, despite a stable quarter at Applications, a tougher outlook there for the remainder of the year.

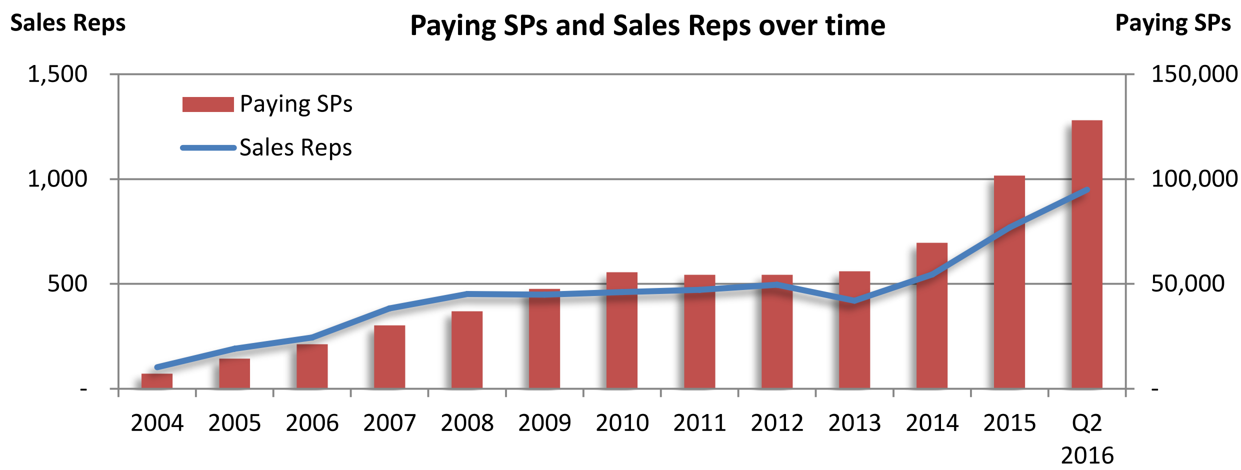
As you heard yesterday, Match Group had an outstanding quarter, with 21% revenue growth and 82% growth in operating income, delivering over $100 million of Adjusted EBITDA in the quarter, a significant milestone. Even more interesting is Match's increasing free cash flow conversion and the resulting free cash flow yield of greater than 5% (see the Match Group Investor Presentation for more details), well ahead of comparable companies. HomeAdvisor again delivered a stellar quarter, with expanding margins and 38% revenue growth (44% in the core domestic business), suggesting our earlier predictions for the year were too conservative. On the other side of the spectrum, both our Publishing and our Applications businesses cut some bets, removed costs and, sadly, eliminated jobs amid declining performance and projections.

HomeAdvisor

In HomeAdvisor, we see a wonderful business with the same marketplace fundamentals as Match, Expedia, Ticketmaster, LendingTree and other businesses we have been fortunate to develop into category leaders. As marketplaces evolve, total addressable market increases, and the winners take more share. Operating leverage and margin eventually pull through in large movements, rather than tiny increments, because the marketplace provides irreplaceable value to a fragmented base of supply and demand. We've had enough experience to notice the signs of a marketplace taking hold and now, twelve years into our ownership of HomeAdvisor (the business was only 5 years old when we bought it), we are seeing these benefits materialize. We can't responsibly spend our incremental revenue gains fast enough, resulting in 12% margins this quarter up from 4% last quarter. The potential "demand" side of HomeAdvisor's marketplace is the 116 million households in the US who spend $400 billion annually on home improvement jobs. The "supply" side comes from the 2 million home service professionals in the US, many of whom have excess capacity to work and a willingness to effectively pay a small fraction of their revenue to bring more customers in the door. HomeAdvisor simply brings them together as efficiently and reliably as possible.

Service Professional ("SP") Network

Every industry leader is always at risk of losing ground to faster, nimbler, younger competitors, and I would expect someone could accomplish in 5 years what took us 17 years as a trailblazer hacking through the brush to achieve. But of the many things that keep me up at night, HomeAdvisor's competitive moat can sometimes lull me to sleep, because building a qualified nationwide SP network simply can't happen overnight in a category where the range of quality workmanship can vary so dramatically. In dating, quality is subjective and the rules of attraction vary; the romantic in us believes that, in love, there's someone for everyone. In home improvement, the rules of attraction are absolute: no one loves a deadbeat. We spend considerable time and resources getting the best SP's into our network – an effort that requires a mix of technology and people – and we are equally focused on preventing and weeding out the low quality professionals.



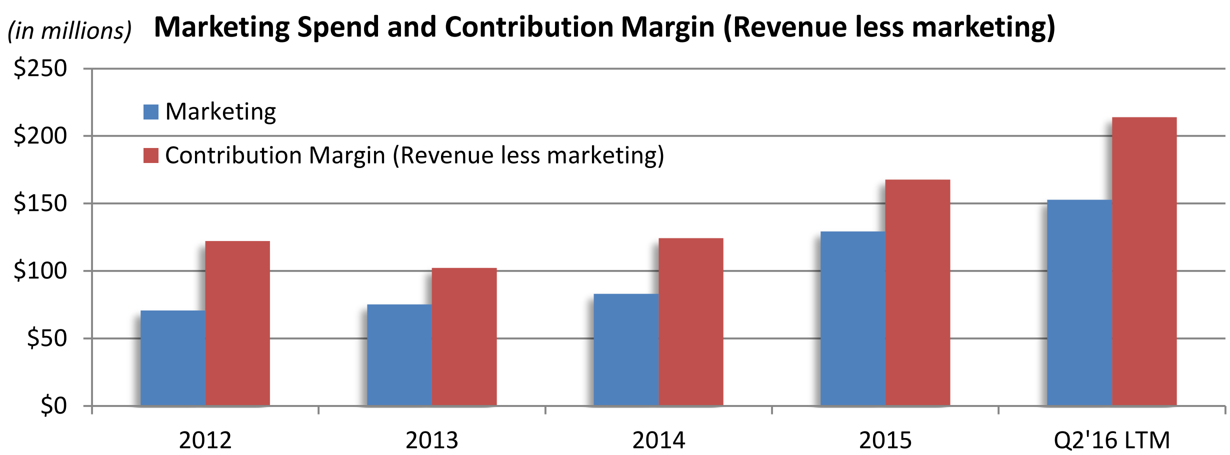
Now, with 128,000 paying SP's in our network (up 54% since last year), HomeAdvisor can address the lion's share of home improvement jobs in the country. But we know from other marketplace experiences that having the *largest* SP network isn't enough to deliver a great user experience – we need the *best* SP network. When current management took over, HomeAdvisor gave up several years of growth to focus on getting the right SP's into the network, and our 6% share of SP's in the US today understates the ongoing quality effort: we reject nearly 10% of SP's at the front door for failure to meet our screening criteria (they often end up on competitor platforms), we kicked 28% of SP's off our platform last year, and approximately 10% of SP's industrywide exit the trade every year. In addition, some SP's simply don't work on our platform, and sometimes our platform doesn't work for them. A neighborhood with only one plumber in a 30-mile radius doesn't need HomeAdvisor; it needs another plumber.

The SP's we keep generally receive much more from the system than they put in. Every SP pays around $300 for an annual subscription and targets spending, on average, an additional $300/month for leads. The average job size on HomeAdvisor is just over $3,000 and ranges from as low as $500 to nearly $1 million. Frequently, one job won can justify an SP's entire annual budget with us.

We also employ 950 talented sales professionals (46% more than we had last year at this time) to reach the right SP's and educate them about our product. Growing a sales force isn't easy, especially when our new hires don't deliver their first cash positive month until month 9 on average (this was 24 months three years ago), creating a real drag on margins as we continue to add sales people. Some of our competitors have cut compensation for their sales professionals to save money. We've been raising compensation, and getting better talent who can tell our story more clearly, attracting better SP's. Other competitors boast of a business model that requires no sales force, which is music to our ears – our potential SP's don't need to balance their time listening to our competitors' pitch! In the meantime, we'll continue to improve – 17 years has allowed for a lot of mistakes, and I suspect the future will allow far fewer.

Consumers

Our direct traffic – users typing in or searching for our brand or going directly to our app – is up 48% over last year and we think a strong indicator of improvements in our brand awareness, with plenty of upside remaining. The biggest opportunity is simply increasing repeat usage. The average household's 6 to 8 jobs a year all could be addressed through our marketplace, but today we only see about 1.5 of those from our customers. In a category with episodic demand, we need to make HomeAdvisor top of mind. We have spent more than $90 million in TV marketing since the beginning of 2013 ($60 million expected in 2016), supplemented by over $260 million of online marketing, all of which yields a healthy contribution margin.



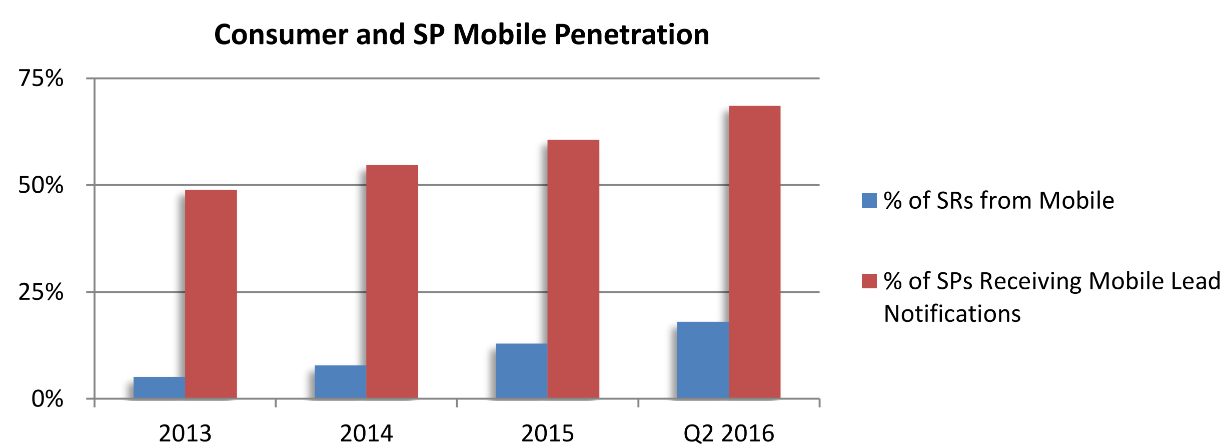
Aided brand awareness has improved from approximately 20% to over 50% over this period and unaided awareness has improved from 4% to 9%. And the broad reach of our national TV spend is another competitive advantage – the size of our SP network enables us to satisfy more of the consumers who see those ads, and generate revenue each time. We pace our marketing based on seasonal trends and available monthly spend capacity from our SP's. By adjusting those dials and capturing the efficiency of our national reach, our television marketing spend directly drives service requests resulting in $1.30 of revenue within a year for every dollar we spend. That incremental 30% flows directly to the bottom line.

We also follow up directly with consumers on nearly 25 percent of service requests. That means we'll make 2-3 million phone calls this year to ensure an optimal customer experience, increasing customer satisfaction and sometimes leading to another job. We will spend over $25 million in operations this year, which is worth every cent in improved satisfaction scores and increased likelihood for repeat business.

Product

One thing we've learned over the course of millions of conversations with SP's is fairly obvious: they want to spend more time working at their profession - plumbers want to plumb, roofers want to roof, cleaners want to clean – and less time on everything else. HomeAdvisor's job is to seamlessly match them to the right job for their expertise and help them get it booked, calendared, and billed. For the consumer, we need to relentlessly reduce the time between job conception and job completion. As a result, we've put significant resources into building and supporting our Instant Connect and Instant Booking products, which remove friction for SP's and consumers, particularly on mobile. And over time and with increased adoption, both products will get exponentially better. Our Instant Booking and Instant Connect products maintain by far the highest customer satisfaction.

Nearly 70% of our SP's get their leads through a mobile interface every month. SP's have had to rely on mobile devices for the bulk of their work day for decades – they're not clipping laptops to their work belts. As a result, we've been delivering leads to them through SMS and mobile for as long as we can recall. Since the beginning of the year, we've embarked on a concerted effort to get SP's to use our app, and now 46% of our SP's use the app within 14 days of signup, as against 29% at the beginning of the year. On the consumer side, still less than 20% of our service requests today originate from mobile devices. That's too low. There are good reasons – homeowners are generally older, which means they spend more time on desktops, and sometimes bigger jobs require more research, which more often happens on a desktop than a phone. But mobile use is also growing materially faster than desktop, and we expect that to continue.



Through Instant Booking we have access to our SP's calendars and seamlessly populate them with revenue generating appointments. We know when jobs are getting done, and – of critical importance for consumers – whether they're getting done on time. Through Instant Connect our SP's immediately speak with our consumers at the exact time of need. And with the direct connection between consumer and SP now established (Instant Connect and Instant Booking now represent 10% of service requests), we have a pretty exciting new set of tools in the works to make the experience even better on both sides. Imagine a world where, years from now, you don't even need a mobile phone or a consumer interface – your connected appliances could initiate service requests through our platform without human intervention; we have the technology today, though adoption isn't imminent.

Across all our products, our proprietary algorithm constantly gets smarter, matching service requests with professionals based on their availability, skill set, progress vs their budgeted leads, location of the job, tenure and rating. Currently we help our SP's batch jobs geographically, increasing their efficiency by decreasing down time. This is a great example of what scale does for us and how marketplaces like HomeAdvisor help to reengineer industries and redefine user experience to expand the addressable market.

International

We own the market leader in the Netherlands and France and we just launched in Italy, with ambitions for continued expansion. Each market requires its own SP network, which, as we know, takes time to build. While our technology and tactics can be shared across borders, a quality SP network and brand require a fresh build in each country, so we've allocated some capital to begin that work with a talented team on the ground to execute. Our international efforts are early but we hope to have more to report as we proceed.

Outlook

Our best days are ahead of us. Adjusted EBITDA will increase more than double this year. The domestic business is growing over 40% as the leader in a $400 billion market in the US. Our sales force is actually gaining efficiency as we grow it faster and we're just getting started on international expansion. If we can move the brand awareness meaningfully, and see it pull through on repeat usage, the opportunity is overwhelmingly powerful. I'll be disappointed if Chris Terrill wasn't sandbagging when earlier this year he predicted $1 billion of revenue in 3 to 5 years.

<u>Other Segments</u>

We have two segments we're managing for cash: Applications and Publishing. Applications had a stable quarter and we cut some more costs in preparation for a weaker outlook. I think we can count on $25 to $30 million of Adjusted EBITDA per quarter this year from Applications, converting to free cash flow at a rate of 80-90%, and if the mobile applications continue to grow at the current pace, we could have a great new line of business. And on the Publishing side, we took decisive action on costs to improve our position. With the cuts this past quarter, we have taken over $50 million of expenses out of the segment's fixed cost base since 2015, over 20% of the total. Our new CEO for that business, Adam Roston, is moving quickly and we believe we can get back to positive cash flow by Q4, which will be a key proof point. We have reasons to be optimistic in Publishing, and understand we'll need to show, not tell, our results in this segment.

During last quarter's earnings call, I said we needed to do a better job of communicating – there was too large of a disconnect between our own perception of our value and that of the market. We still have a way to go, but I believe that the more of our thinking we share, the more progress we'll make. I'm doing double-duty for a little while as interim CEO of Vimeo and will report on that work next quarter. In the meantime, we have a lot of work to do and appreciate your support.

Sincerely,

Joey Levin
CEO

Full Year 2016 Outlook

Please find below our updated full year 2016 outlook. We confront investment choices every day, and as stewards of your capital, will deviate from guidance when we have an attractive opportunity that drives long-term value at the expense of short-term results. And of course, sometimes we'll simply be wrong about the future. Amply warned, here's our current outlook for the year:

(in millions)	**FY 2016 Guidance**
Adjusted EBITDA	
Match Group	$400-$415
HomeAdvisor	43-47
Publishing	0-10
Applications	110-120
Video	(25-15)
Corporate & Other	(55-50)
Total IAC Adjusted EBITDA [a]	**$473-$527**
Stock-based compensation expense	(110-100)
Goodwill impairment	(275)
Depreciation	(75-70)
Amortization of Intangibles	(80-75)
Acquisition-related fair value adjustments	(15-10)
Operating (loss) income	**($82) - ($3)**

(a) Includes $5.9 million and $2.6 million restructuring costs year-to-date at Publishing and Applications, respectively ($4.5 million and $1.9 million in Q2 2016)

- *Match Group* - Full year Dating revenue expectation unchanged at $1.10-1.14 billion (2-3% sequential increase in Q3 and 4-6% sequential increase in Q4). See Match Group Investor Presentation for further detail.
- *HomeAdvisor* - For Q3 and the full year, we continue to expect revenue to grow faster than 2015. Year-over-year Adjusted EBITDA growth will be meaningful for the foreseeable future, and flat to up a bit sequentially in Q3 from Q2 and then down sequentially in Q4 due to seasonality.
- *Publishing* - We expect Publishing revenue to be down slightly in Q3 sequentially, reflecting the sale of ASKfm, before increasing sequentially in Q4. In Q3, we expect Adjusted EBITDA losses to narrow to mid-single digit levels and return to overall profitability in our seasonally stronger Q4.
- *Applications* - We expect Applications revenue to decline a bit sequentially in Q3 and then revenue settles between Q2 and Q3 levels prospectively. We expect $25 to $30 million of Adjusted EBITDA per quarter for the balance of the year.
- *Video* - We expect Video revenue in Q3 to increase double digits sequentially from Q2 with further sequential increases in Q4. We expect Video losses in Q3 comparable to Q2 levels and then profitable in Q4 due primarily to the timing of Electus projects.

Appendix

Webcast and Conference Call Details

IAC will audiocast a conference call to answer questions regarding the Company's 2nd quarter financial results on Thursday, July 28, 2016 at 8:30 a.m. Eastern Time. The live audiocast will be open to the public at www.iac.com/Investors. This letter will not be read on the call.

Non-GAAP Financial Measures

This letter contains references to certain non-GAAP measures, which, as a reminder, include Adjusted EBITDA. These non-GAAP financial measures should be considered in conjunction with, but not as a substitute for, financial information presented in accordance with GAAP. Please refer to our 2nd quarter 2016 press release and the investor relations section of our website for all comparable GAAP measures and full reconciliations for all material non-GAAP measures.

Safe Harbor Statement

This letter and our conference call, which will be held at 8:30 a.m. Eastern Time on July 28, 2016, may contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The use of words such as "anticipates," "estimates," "expects," "plans" and "believes," among others, generally identify forward-looking statements. These forward-looking statements include, among others, statements relating to: IAC's future financial performance, IAC's business prospects, strategy and anticipated trends in the industries in which IAC's businesses operate and other similar matters. These forward-looking statements are based on management's current expectations and assumptions about future events, which are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. Actual results could differ materially from those contained in these forward-looking statements for a variety of reasons, including, among others: changes in senior management at IAC and/or its businesses, changes in our relationship with, or policies implemented by, Google, adverse changes in economic conditions, either generally or in any of the markets in which IAC's businesses operate, adverse trends in any of the industries in which IAC's businesses operate (primarily the online advertising, general advertising and dating industries), our dependence on third parties to drive traffic to our various websites and distribute our products and services in a cost-effective manner, our ability to attract and convert visitors to our various websites into users and customers, our ability to offer new or alternative products and services in a cost-effective manner and consumer acceptance of these products and services, our ability to build, maintain and/or enhance our various brands, our ability to develop and monetize mobile versions of our various products and services, foreign currency exchange rate fluctuations, changes in industry standards and technology, the integrity and scalability or our systems and infrastructure (and those of third parties), our ability to protect our systems from cyberattacks, operational and financial risks relating to acquisitions, our ability to expand successfully into international markets and regulatory changes. Certain of these and other risks and uncertainties are discussed in IAC's filings with the Securities and Exchange Commission. Other unknown or unpredictable factors that could also adversely affect IAC's business, financial condition and results of operations may arise from time to time. In light of these risks and uncertainties, these forward-looking statements may not prove to be accurate. Accordingly, you should not place undue reliance on these forward-looking statements, which only reflect the views of IAC management as of the date of this letter. IAC does not undertake to update these forward-looking statements.