ZILLOW GROUP, INC. Q2 2015 EARNINGS – PREPARED REMARKS

RJ Jones, VP of Investor Relations:

Thank you. Good afternoon and welcome to Zillow Group's second quarter 2015 earnings conference call. Joining me today to talk about our results are Spencer Rascoff, Chief Executive Officer, and Kathleen Philips, Zillow Group's new Chief Financial Officer.

During the call we will make forward-looking statements regarding future financial performance and events. Although we believe the expectations reflected in the forward-looking statements are reasonable, we can't guarantee these results, and actual results may differ materially. We caution you to consider the risk factors in our SEC filings which could cause actual results to differ materially from those in the forward-looking statements made in the press release and on this call.

The date of this call is August 4th, 2015, and forward-looking statements made today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of new information or future events.

During this call, we will discuss GAAP and non-GAAP measures. We will also discuss results on both a reported and pro forma basis. Reported results were prepared in accordance with GAAP. For comparative purposes, pro forma results assume the February 2015 acquisition of Trulia occurred on January 1, 2014, and reflect certain adjustments and exclusions described in our filings. We encourage you to read our press release, as it contains information about our reported and pro forma results, including reconciliation of non-GAAP financial measures.

In our remarks, the non-GAAP financial measure Adjusted EBITDA is referred to as EBITDA, which excludes other income, depreciation and amortization expense, share-based compensation expense, acquisition-related costs, restructuring costs and interest expense.

This call is being broadcast on the Internet and is available on the Investor Relations section of the Zillow Group website. A recording will be available after 8:00pm Eastern time today. Please note that the earnings press release is available on our website and, after the call, a copy of today's remarks will also be available on our website.

Today we will open the call with prepared remarks, followed by our standard live question-and-answer session. During the Q&A, we will answer questions asked via Twitter and take questions from those dialed into the call. Individuals may submit questions by tweeting @ZillowGroup using the hashtag ZEarnings. I will now turn the call over to Spencer.

Spencer Rascoff, CEO:

Thank you for joining us today to discuss our second quarter results.

I want to start by thanking our outgoing CFO, Chad Cohen, for his nine years of contributions to Zillow, and I wish him all the best in his new role as CFO at a life sciences biotech company. Chad is going to have the opportunity to build out the financial function again from the ground up, which is where his passion lies. I have no doubt he will be as successful at his new company as he was at Zillow.

With me on the call today is Kathleen Philips, our newly appointed CFO. Most of you already know Kathleen – she has been with Zillow for five years, first as our General Counsel and for the last two years as our Chief Operating Officer. Kathleen has been a critical part of our executive team for years, and played a pivotal role in all of our key corporate finance initiatives including our IPO four years ago, our two follow-on equity offerings, and all 10 acquisitions, the largest of which was Trulia. Kathleen oversaw the entire Trulia acquisition process, FTC review, and subsequent integration. During her time as COO, she was already running M&A, corporate development, human resources, legal and customer support. Before Zillow, I worked closely with Kathleen for five years at Hotwire where she was our General Counsel and on our senior leadership team. After evaluating many excellent external CFO candidates, we are confident that Kathleen is perfectly positioned to be Zillow Group's new CFO, and I'm very excited to work with her in her new role. Kathleen inherits an incredible finance organization including Jennifer Holstein (VP of Financial Reporting and Compliance) and Jessica Lee (VP and Corporate Controller), both of whom have longstanding tenure at the helm of Zillow's finance function. Our finance team is in great hands.

As Kathleen moves into the CFO role, I'm also pleased to announce Amy Bohutinsky as our new Chief Operating Officer of Zillow Group. Amy has been with Zillow for 10 years and was most recently our Chief Marketing Officer, where her team helped grow Zillow's brand from almost nothing to the powerhouse it is today. The quality, tenure, *stability* and camaraderie of our management team continues to be a key strength of ours, and a differentiator, and I'm very pleased that we were able to make these important organizational changes without missing a beat.

Turning now to the second quarter: first, I'll start with the operating results. Next, I will provide an update on our business, touching upon our four priorities, which are: bringing Trulia into Zillow Group, growing our collective Zillow Group audience, growing our agent advertising business, and growing our emerging marketplaces. Next Kathleen will run through our financials, and then we'll open the call for questions. As usual, we'll take questions from the conference call, and from Twitter with the hashtag “#ZEarnings”. And after the call, I’ll take further questions on Twitter.

Starting with our results, Zillow Group had a strong second quarter as we exceeded our expectations. Our revenue grew 20 percent year over year on a pro forma basis to over $171 million in Q2, which was about $2 million higher than the outlook we gave on our May 12th call. Continued strength in our marketplace categories, which include real estate and mortgage advertising, along with substantial audience growth, drove these revenue results. Across our Zillow Group portfolio, we averaged 141 million monthly unique users during the quarter. Within Zillow Group, our flagship Zillow brand continues to lead the category in traffic across mobile and web, growing 22% year-over-year per Google Analytics, and according to comScore, receiving nearly 50% of all category visitors. Second quarter EBITDA was about $21 million, which far exceeded our outlook of around $4 million. There were a few causes of this EBITDA beat. I’ll tick through them in order from largest impact to smallest: First, within marketing, we intentionally shifted some ad expenses to Q3 because we achieved our audience goals with a lower and more efficient ad spend. Second, we saved a few million in combined company expenses from reduced sales team expense and other synergies in the quarter. Third, Q2 was the first quarter post-closing and our forecast for Q2 expenses reflected the uncertainties of the transition as we brought the two companies together. Finally, the revenue beat flowed through to EBITDA.

Overall, we continue to execute well across our portfolio of brands during this year of transition, as we remain intensely focused on our top priority of fully integrating agent ad sales between Zillow and Trulia.

What remains clear to us is that the multi-brand portfolio strategy is the right one. Consumers value choices in how and where they can search for their next home and connect with the best local professionals. By operating multiple brands, our audience grows as consumers increasingly engage with Zillow Group brands. An example of this is on mobile, where according to comScore, Zillow Group brands account for 72 percent of all mobile only real estate category visitors. This is extraordinary, and represents tremendous opportunity for our advertisers, as well as validating our acquisition of Trulia.

But perhaps the most tangible benefit from our massive scale so far was our seamless transition to direct listings feeds in April. MLSs, brokerages, and agents understood that Zillow Group offered access to the largest consumer home shopping audience, and they signed up at an unprecedented rate. We now receive significantly more high quality listings directly from MLSs than we did when a third party vendor provided us with listings, and we now have more than 300 MLSs sending us data directly, having added 81 new MLS partnerships in just the last 3 months.

Other benefits of our combined scale with Trulia and Zillow include the continuing trend of our most tech-centric and marketing savvy advertisers increasing their buying with us. This comes through in our data on the growth rate among our largest advertisers. For example, at the end of the second quarter, the number of agents spending more than $5,000 per month grew 48 percent year-over-year. Agents spending over $2,500 per month grew 44 percent year-over-year. And agents spending over $1,000 per month grew 34 percent year-over-year. The churn rate among these cohorts is very low, validating our strategy of focusing on high-performing agents.

Already we have fully integrated our rentals, mortgages, display, and back-of-the-house operations with Trulia. In fact, we have now moved up the timeline to integrate our agent advertising business by several months, expecting to complete this by the end of the third quarter. We will be slowly rolling out the cross-brand Premier Agent ad product that combines both mobile and Web presence for our agent advertisers over the next few weeks. As we have done before when Zillow made major changes to our ad products, the rollout is staged incrementally so that we can iterate on successes and minimize potential disruptions. Our sales force has been preparing for months to execute the launch successfully. Account transitions for our customers, sales reps and account managers are mapped out, and ready to go. Once the product is launched, the revenue from our agent advertisers will be Zillow Group and will no longer be separate Zillow and Trulia revenue streams. Agents will buy advertising from Zillow Group, and their ads will be served across all platforms, including mobile apps, mobile web and desktop web; and across all of our owned and operated national consumer brands, including Zillow, Trulia, and HotPads, and the real estate search platforms we power including: Yahoo, MSN, AOL, HGTV and Leju in China. We are excited about the significant progress we have made to this point, and are looking forward to gaining further speed as the Trulia integration reaches its final stages.

Meanwhile, the impact on Trulia users and advertisers is consistent with what we laid out in the operational update call on April 14th, and in our first quarter call on May 12th. We made significant changes to the Trulia agent ad product in the second quarter that are impacting the business, as we expected. Changing the Trulia agent advertiser list from four default checks to one default check – which is the Zillow standard, and we believe to be a more consumer-friendly model - has resulted in agent cancellations from lower ARPA agents, and that’s ok. This change positions Trulia for the ad product integration with Zillow, and benefits high ARPA agents and consumers alike. Additionally, we have sunsetted promotional discount pricing on Trulia, which has resulted in lower advertiser net adds. This too, is desired, as those impressions are now going to better agents who value the leads more and provide better service. These Trulia agents who departed over the past few months were lower ARPA and lower-producing; the agents who remain are higher-converting and higher ARPA.

As we integrate Trulia's agent business, we are also very focused on growing the Trulia consumer brand and product. Over the past year, Trulia's topline audience growth has stalled. Together, our Zillow and Trulia product and marketing teams are working to reinvigorate growth. We are sharing best practices across the brands, and there are a number of areas where our experience with Zillow can help Trulia. Soon, when the Zillow and Trulia ad products will be merged, the combined audience size of Zillow plus Trulia becomes much more relevant than traffic on one brand or the other. However, Trulia traffic growth is a priority, we are putting significant resources and effort behind it, and we will turn around its traffic trends. It is worth mentioning that this relates to topline audience, and the impact is much less severe for bottom-of-the-funnel contact volumes.

In the midst of this flurry of integration, the fundamentals of our flagship Zillow brand are the strongest that they have ever been. Our Zillow audience continues to grow, and our advertising is working. Not only does the Zillow brand alone represent nearly half of the real estate category in market share of visitors, but Zillow Group now represents the 32nd largest web property in America. We have maintained our market share of traffic, nearly double that of our nearest competitors, and the majority of our growth is coming from organic, or free, traffic channels. Mobile continues to be a strong driver of growth, with over 70 percent of weekend visits to Zillow coming from a mobile device. Lastly, revenue growth in Zillow's Premier Agent program was 48 percent year over year, reflecting continued increased spending by our most prolific agent advertisers. All in, these are stellar numbers for Zillow core, reflecting years of product innovation and brand building.

A recent development which enables us to add depth to our industry value proposition is our pending acquisition of DotLoop. DotLoop simplifies the transaction process that consumers and agents go through when buying and selling homes by making it paperless. DotLoop brings the transaction online, from the creation of a listing agreement to the submission of offers to the actual closing, driving speed and efficiency into the process. Brokerages and agents have been adopting paperless transaction services rapidly, as they eliminate many inconveniences for themselves and their clients. We are excited about the potential that DotLoop offers our 10,000 brokerage partners and their agents to increase their conversion of consumer contacts into sales. Today, real estate agents create more than 300,000 loops and nearly half a million people sign real estate documents in DotLoop each month. We look forward to combining our scale with DotLoop services, enhancing its products and expanding its network effects. The consideration for DotLoop was substantially in cash. The decision to use cash with retention incentives in stock reflects management and the Board's confidence in the long-term opportunity for Zillow Group, and our overall sensitivity to dilution.

Now to our emerging marketplaces.

Our New York City brand, StreetEasy, continues to excel on all fronts. This year, we began advertising StreetEasy in Manhattan for the first time, and we're extremely pleased with the results on audience growth and revenue. In particular, the StreetEasy's team's hard work on product and organic growth has paid off – StreetEasy's audience is 90 percent larger today than when we acquired it two years ago.

In Zillow Mortgages, we recently changed our pricing model from cost-per-click to cost-per-lead. The transition was seamless and welcomed by our mortgage advertisers. With our mortgage revenue up 44 percent in the quarter: traffic, loan requests, contacts and revenue all continue to grow ahead of mortgage industry trends.

In Zillow rentals, we continue to gain traction. Our total rentals audience remains massive – by far number one in the category according to comScore, despite competitors' ad spend. During the quarter we launched a new ad product called "Zillow Rent Connect: Boost" which is selling well. We now provide property managers the opportunity to purchase prime advertising space at the top of renters' search results. Our new premium advertising service helps multifamily rental professionals shine a spotlight on property promotions and specific units. And we continue to evolve our nascent sales team to support our revenue growth into the large advertising opportunity in rentals.

Last week we announced that we will execute a change in our capital structure related to our long term focus. Later this month, we will issue a class of non-voting Class C stock that our shareholders approved last December. Each Zillow Group holder of Class A or Class B shares will receive two Class C shares, basically a three-way stock split. C shares will trade under the symbol "Z," and A shares will trade under the symbol "ZG". For Zillow Group, extending our dual-class structure through the issuance of C shares allows us to continue our focus on long-term growth and innovation. We are focused on making the right decisions for the business today that can lead to outsized total shareholder returns over the course of years. This structure ensures that we can continue to take big swings, and set our sights on the long term.

To conclude –

We've been very focused operationally on the integration of Trulia, and made great progress on a number of fronts. As with most mergers of any scale, it has required a great deal of time, attention and energy. I'm very pleased that we will have successfully combined all advertising products by the end of the third quarter, well ahead of the timetable we shared on our May 12th conference call. Most importantly, the strategic rationale for the combination remains extremely strong, and we're already seeing benefits of our combined scale in many parts of the business. We are as fired up as ever to power through this time of transition and be well set up for a great 2016.

I'll now turn the call over to Kathleen to review the financial results in more detail.

Kathleen Philips, CFO:

Thanks, Spencer. Hello to shareholders, employees, analysts, and media on today's earnings call. I am excited and honored to begin my new role as CFO of Zillow Group. Over the last few years as COO, I have spent a lot of time with many investors and analysts, and I look forward to increasing that dialogue in my new role.

Today I will discuss our second quarter 2015 financial results on a pro forma basis for comparative purposes. Next I will provide our outlook for Q3 and full year 2015. Then we will open up the call for questions.

As we get started, I would like to remind everyone that our pro forma results assume the acquisition of Trulia occurred on January 1, 2014, and do not include the impact of acquisition-related costs and restructuring costs. Note that our GAAP and pro forma financial results along with our pro forma comparisons have been included in our second quarter 2015 financial results press release, which contains important information about how the pro formas were prepared. Unlike our first quarter 2015 results, second quarter financial results reflect a full quarter contribution from Trulia. Thus our GAAP and pro forma financial results are similar, with the exception of net loss which includes acquisition-related costs, one-time share based compensation expense, and restructuring costs on a GAAP basis, and excludes them on a pro forma basis.

Now, let's dive into our results, starting with traffic.

Traffic growth continued to be solid through the second quarter even as we made substantial progress on the Trulia integration. In the second quarter of 2015, we attracted 141 million average monthly unique users to Zillow Group's mobile applications and websites. On a pro forma basis, this was an increase of nearly 15 million users from the same period last year, about as large as the fourth or fifth largest site in the category. As a reminder, our unique user metric is a combined measure reflecting traffic across all four of our consumer-facing brands: Zillow, Trulia, HotPads and StreetEasy, and excludes Market Leader. We report it this way as it's a measure of the scale we offer to advertisers. We will continue reporting our traffic on a quarterly basis, consistent with the industry and aligned with how we report our other metrics.

Our Zillow Group agent business continued to be strong and experienced robust growth. The annualized run rate for our agent advertising business reached nearly $456 million at the end of the quarter compared to $349 million at this time last year, which is a 30 plus percent increase. This still represents a very small portion of the approximately $10 billion spent by real estate advertisers per year. As Spencer alluded to, this result is driven by a combination of our highest spending agent advertisers buying more impressions to expand their presence on our platform.

During the quarter, ARPA was $375 for agent advertisers, increasing 18 percent year-over-year on a pro forma basis, and our ending agent advertiser count of 101,297 increased 11 percent over last year on a pro forma basis. Consistent with how we report our traffic, we will continue to report these output figures on a quarterly basis. Note that the agent advertiser count represents a sum total of paying accounts – not just individual real estate agents. As Spencer noted, increasingly we are benefiting from agent teams and independent broker agents represented by one account that buy advertising at much higher levels than the average.

There are a lot of moving pieces in our agent ad business:

- from the changes we made to the Trulia ad product which lay the groundwork for integration with Zillow;
- to the integration of the ad platforms, which is ahead of schedule;
- to the changing industry dynamics wherein more higher ARPA agents are buying even more advertising from Zillow Group.

Each of these moving parts affects our near term results differently. While each element evolves independently, in combination they establish a solid launching pad for our business in 2016 and beyond.

Moving now to the financials – for year-over-year comparative purposes, I will discuss our second quarter 2015 financial results on a pro forma basis.

Total revenue for the second quarter increased 20 percent year-over-year to $171.3 million, from $142.8 million in the same period last year. Total revenue, excluding Market Leader, increased 25 percent year-over-year to $158.7 million from $126.8 million in Q2 2014.

Looking at our primary revenue category: marketplace revenue was $145.5 million, which includes $12.5 million of Market Leader revenue, and grew 29% year-over-year. Excluding Market Leader, marketplace revenue would have grown 38% year-over-year. Marketplace revenue now accounts for 85 percent of total revenue.

Taking a closer look into our real estate subcategory, which includes our agent advertising, Diverse Solutions, StreetEasy, and rentals advertising revenue, our second quarter real estate revenue reached $122.6 million and grew 37 percent year-over-year.

Moving now to mortgages, our revenue reached $10.4 million, which represents a 44 percent increase year-over-year. Loan requests grew 151 percent to more than 13 million submitted during the second quarter.

And in our display category, revenue was $25.8 million, down 15 percent over the same period last year and in line with our expectations. This decline was intentional – we removed some intrusive display ad units from our Trulia brand in order to improve the user experience. Display now accounts for 15 percent of total revenue, continuing our favorable long term mix shift towards marketplace.

Now, let’s take a deeper look at our operating expenses by line item. Note this is the first full quarter of contribution from Trulia.

Our cost of revenue during the quarter was $17.0 million, or 10 percent of revenue.

Next, aales and marketing expense was $87.9 million, or 51 percent of revenue, which was lower than internal forecasts due to lower than expected advertising expenses to achieve audience growth, as well as lower than anticipated sales costs resulting from sales team efficiencies. Headcount-related expenses attributed to the Trulia acquisition were lower than we forecasted. Zillow Group has not seen any slowdown in our ability to recruit terrific salespeople in our Seattle, Denver and Irvine sales offices, and our hiring standards have only grown more stringent.

Technology and development costs in the second quarter were $51.7 million, or 30 percent of revenue, and lower than our outlook. A majority of the technology and development cost variance was due to headcount-related expenses, along with reduced capitalized wages, and lower than anticipated investment levels in property data and technology for operations.
G&A costs in the second quarter were $43.8 million, or 26 percent of revenue, which was slightly higher than our outlook due to professional service fees which include legal and accounting costs, with the majority of G&A expenses due to head-count related expenditures.

Pro forma net loss was $26.7 million in the second quarter, compared to a pro forma net loss of $29.6 million in the second quarter of 2014. Pro forma second quarter 2015 basic and diluted loss per share was 46 cents, based on 58.7 million basic and diluted weighted-average shares outstanding.

The acquisition-related costs and restructuring costs totaling $8.3 million resulted in a GAAP net loss of $38.7 million. Second quarter 2015 basic and diluted loss per share was 66 cents. On a non-GAAP basis, which excludes share based compensation and acquisition-related costs and restructuring costs, basic and diluted non-GAAP loss per share was 1 cent.

As Spencer reported, adjusted EBITDA was $21 million, or 12 percentof revenue, $17 million higher than the second quarter 2015 outlook we provided on May 12th.

Zillow Group ended the second quarter of 2015 with a little over 2,000 employees. The pending acquisition of DotLoop will increase our number of employees by around 100.

Now turning to our Zillow Group Outlook for Q3 and Full Year 2015:

Third quarter 2015 revenue is expected to be in the range of $175 to $177 million, which includes Market Leader. Excluding anticipated Market Leader revenue of approximately $10 million, the year-over-year growth rate of third quarter revenue is expected to be approximately 18 percent. Real estate revenue is anticipated to grow 25 percent year over year.

Display revenue on a dollar basis is expected to be in-line with our Q2 2015 results.

Our EBITDA for the third quarter is expected to be in the range of $18 million to $19 million.

Due to the impact of our upcoming class C share issuance, and the effective 3-for-1 share split, our Q3 2015 basic weighted-average shares outstanding is expected to be approximately 176.5 to 178.5 million and our diluted weighted-average shares outstanding is expected to be in the range of 193.0 to 195.0 million.

Turning now to our 2015 full year outlook, we are reaffirming our full year pro forma 2015 revenue guidance of $690 million. This includes Market Leader revenue of $40 million. As of the end of Q2, the estimated net carrying value of the assets and liabilities of Market Leader is approximately $35 million.

We are raising our full year pro forma EBITDA outlook to the range of $85 to $90 million, which includes Market Leader. Thus, we now expect the fourth quarter EBITDA margin to be approximately 14 percent.

We expect full year, pro forma depreciation and amortization to be approximately $90 million.

Due to the impact of our new class C shares, our full year 2015 basic weighted-average shares outstanding is expected to be approximately 169.0 to 171.0 million and our diluted weighted-average shares outstanding is expected to be in the range of 185.5 to 187.5 million.

For GAAP modeling purposes only, we now expect full year 2015 acquisition-related costs to be approximately $18 million and restructuring-related costs to be in the range of $31 to $33 million. The vast majority of these costs have been recognized in the first half of 2015.

I would like to take a moment to address Zillow Group's near and long term risk profile. In the near term, as we enter into the most intense phase of our integration, we believe that the financial outlook we have provided is appropriately adjusted to balance the uncertainties, risks and opportunities that may arise during this time of transition. The most significant of these risks relates to the upcoming migration of over 100,000 agent advertiser accounts to our combined agent advertising platform. Our outlook contemplates and incorporates possible sales challenges. The good news is that we're getting all of this behind us sooner than we expected. We will enter 2016 with the foundation complete to support our future growth into the massive market opportunity.

Our long-term orientation has always been an advantage of ours. We have significantly de-risked our business over the past six months:

- from the successful transition to direct listings, releasing us from dependence on a third party listings aggregator and resulting in significantly more listings with better quality;
- to consolidating the category upon the completion of the Trulia acquisition;
- to the integration of the ad platforms, which is ahead of schedule;
- to focusing on increasing higher ARPA agents;
- to growing brand awareness where we are now the category leader.

We have significantly enhanced the foundation of the business. Today, Zillow Group is more valuable, more stable, and better positioned to capture the huge real estate advertising TAM.

To conclude, we continue to accelerate our growth of audience and advance our emerging home-related marketplaces while moving rapidly through the Trulia integration. We have accelerated the timeline of our ad sales platform integration, and we are now more confident about finalizing all integration activity by the end of 2015. Looking out further, we remain on track to realize $100 million in cost synergies and avoidances by the end of 2016.

With that, Spencer and I will open it up for questions from those dialed into the call, and to questions submitted via Twitter with the hashtag ZEarnings.