

ZILLOW GROUP, INC. Q3 2015 EARNINGS – PREPARED REMARKS

NOVEMBER 03, 2015 -- 2 p.m. Pacific Time

RJ Jones, VP of Investor Relations:

Thank you. Good afternoon and welcome to Zillow Group's third quarter 2015 earnings conference call. Joining me today to talk about our results are Spencer Rascoff, Chief Executive Officer, and Kathleen Philips, 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 November 3rd, 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 SEC filings. We encourage you to read our press release, as it contains important 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, loss on divestiture of business, interest expense, and income tax benefit.

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 8:00 p.m. 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 and all year-over-year comparisons are pro forma unless otherwise noted or the context otherwise requires. We will follow the prepared remarks with 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 #ZEarnings. I will now turn the call over to Spencer.

CEO Spencer Rascoff:

Thank you for joining us today on our Q3 call. I'll start with some highlights from the quarter and then talk about our long-term strategy. Then Kathleen will take us through a deeper dive on our financials. We will then open up the call to questions.

The third quarter was a remarkable one for Zillow Group. In August, we completed our most ambitious undertaking to date. We finished the final phase of our Trulia integration four months ahead of schedule and launched our unified Premier Agent advertising platform. More on that in a moment.

Even as we transitioned our agent ad platform during the quarter, our financial results were solid. Revenue for the third quarter was nearly \$177 million and at the high end of our outlook. Our Premier Agent revenue grew 25 percent year over year in-line with our outlook, and our mortgages, rentals and New York City marketplaces all grew revenue even faster.

Looking at top of the funnel traffic across our portfolio, our seasonal traffic peak hit nearly 150 million unique users in the month of July. We now have around 60 percent market share of unique users across mobile and web in the category according to comScore. And more importantly, on mobile, Zillow Group brands get around 70 percent of all mobile-exclusive users in the category. Moreover, our two largest brands, Zillow and Trulia, each grew leads to agents faster than their top of the funnel traffic stats, and Zillow Group combined grew leads to Premier Agents 36 percent year-over-year in Q3. We are also off to a strong start in Q4, with October leads to Premier Agents up 37 percent year-over-year, and Trulia's leads to Premier Agents particularly strong over the last few weeks.

On the last earnings call I said there was uncertainty going into the ad product integrations, but that we were well prepared. We also baked that into our outlook for Q3, and I'm pleased to report that our preparation and execution mitigated those potential risks. As a result, we recorded a significant beat on EBITDA, which Kathleen will elaborate on shortly.

As a result of the strong Q3 results, we are updating our full year 2015 estimates -- we now expect \$675 to \$680 million in revenue (which is in line with last quarter's guidance excluding Market Leader in the fourth quarter) and \$95 to \$100 million in EBITDA (which is an increase over last quarter's guidance of \$85-\$90 million). Revenue is tracking right where we expected it to be, and we're ahead on EBITDA.

These numbers include our estimate of dotloop's revenue from the date of the acquisition's closing on August 20th through the end of 2015, and now exclude Market Leader's 4th quarter revenue (since it sold on September 30th). It also includes Trulia for the full year 2015.

Turning to our Premier Agent business, we had a very successful annual event with 1,000 of our top Premier Agent advertisers in Las Vegas where we announced a brand new free Premier Agent mobile app to a very warm reception. The new app will help agents convert their Zillow Group leads into transactions more efficiently. This "Premier Agent" branded CRM is in addition to our more than 50 CRM partners who participate in our "Zillow Tech Connect" program, which sends Zillow Group leads directly into agents' CRM of choice.

The Premier Agent forum was energizing and inspiring -- as was clear on social media from the many posts by Premier Agents on twitter, Instagram and Facebook. It was similar to last year's successful event, but there was one big difference. The number of high-performing agents who have built big

businesses on top of the Zillow Group platform has grown immensely. These agents understand and embrace technology, lead conversion, reputation management and online marketing; and they have put Zillow Group in the center of their business plans for local market leadership.

We are continuing to focus on growing revenue from these high producing agents, and not from increasing the overall number of advertisers. These higher-spending agents typically deliver better service to consumers, and we prioritize the sale of ad impressions to them. We anticipate these highly productive agents will continue to increase their spend with us to grow their business and grow their market share in their respective cities. In line with this, we will continue to encourage lower performing agents to leave and resell their inventory to agents with higher ROI. This will reduce our number of advertisers and connect more home shoppers with better agents, and we expect this will reduce our sales and support costs over time as well. As I've said many times, we do not manage our business to the metric of advertiser count; we manage our business to total Premier Agent revenue, which is growing 25 percent year-over-year.

We're in the midst of our 2016 planning process and although it's early, we are targeting a higher total revenue growth rate in 2016 than the expected 2015 revenue growth rate of 18 percent (including Market Leader) or 24 percent (excluding Market Leader).

We are also prioritizing revenue growth over margin expansion given the huge TAM in agent advertising, rentals, mortgages, and New York City. Our largest business – agent advertising – is still a very small fraction of what agents spend on total advertising, and we are investing very heavily in its growth. We will also continue investing in product development and advertising for our consumer brands in 2016, along with growing awareness of our mortgages and rentals products.

Over the past four years as a public company, we have evolved into the definitive category leader. By consolidating and rationalizing the category through the Trulia acquisition, and completing the integration quickly, we have entered the next phase of our evolution in a position of strength. We further enabled our team to focus on innovating and accelerating our growth, now untethered from factors that previously held us back. From accessing direct listings feeds with more than 350 MLS partners, to establishing the foundation for our brand portfolio strategy with our unified advertising platform, to focusing on attracting highly productive advertisers across our marketplaces and providing them with products to help drive increased conversion – we are more in control of our destiny now than ever before. Moving beyond integration, our strategic priorities remain the same: grow our audience, because advertisers follow audience; grow our real estate agent marketplace; and grow our emerging marketplaces in mortgages, rentals, and New York through our portfolio of brands. We are finishing this year of transition in great shape. I said a few times during 2015 that “2016 can't come soon enough”, and now that we're through the integration I am incredibly excited for the accelerating growth ahead in 2016 and beyond. Now, Kathleen will walk you through our financials.

Kathleen Philips, CFO:

Thank you, Spencer and hello to those who have joined us on today's earnings call. For comparative purposes, I will discuss year-over-year comparisons of our third quarter financial results on a pro forma basis unless otherwise noted or the context otherwise requires. Next I will provide our outlook for Q4, and for the full year 2015, and recap our 2016 preview. Finally, 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 close of Trulia occurred on January 1, 2014, and do not include the impact of acquisition-related costs and restructuring costs, in addition to certain other adjustments. Note that our GAAP and certain pro forma financial results, along with our pro forma comparisons, have been included in our third quarter 2015 financial results press release, which contains important information about how the pro formas were prepared. For the third quarter, our GAAP and pro forma financial results are similar, with the exception of net loss, which includes acquisition-related costs 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.

In the third quarter of 2015, as we completed the most challenging portion of the Trulia integration, we attracted over 142 million average monthly unique users to Zillow Group's mobile applications and websites, achieving a peak of nearly 150 million unique users in July. 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.

Our Zillow Group agent advertiser business performed remarkably well while undergoing a substantial change as we combined the Zillow and Trulia sales teams and ad platforms. We closed the third quarter with 96,965 advertisers, a decrease of 2 percent over the same period last year, but the associated revenue – our real estate revenue – rose 27 percent in the quarter to \$129 million, and the annualized run rate for our agent advertising business reached \$468 million at the end of the quarter compared to \$397 million at this time last year. This desirable result is driven by our highest spending advertisers buying more impressions to expand their presence on our platform – and is the result of our intense focus on increasing advertiser spend by our high performing agents

When we reached out to our nearly 100,000 advertisers during the integration of our ad platforms, the response was overwhelmingly positive. Most advertisers kept their spending levels the same, and the cancellation rate was below our normal level. In fact, new sales to existing advertisers made up 69 percent of total bookings in Q3, the highest it's ever been.

For the third quarter, average revenue per advertiser or ARPA was \$402, increasing 20 percent year-over-year on a pro forma basis, and same agent advertiser sales grew over 50 percent higher than last year. For this purpose, a same agent is an existing agent who has been on our platform for more than one year. Consistent with previously discussed trends, 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.

It is clear now more than ever before that our strategy of working with higher ARPA advertisers is paying off. Growth of the advertiser cohort that spends more than \$5,000 per month was 57 percent on a total dollar basis and 45 percent in advertiser count year-over-year, and churn in this cohort continues to be minimal. Conversely, it was our lowest spending advertisers who had the highest rate of churn. Specifically, during the third quarter, the average spend of agents who stopped advertising with us was \$270, roughly half of the ARPA of agents who remained on the platform.

We intend to actively grow high spending agents and teams on our platform, and at the same time encourage low ARPA, low producing advertisers to not renew. This approach drives revenue growth by placing impressions in the hands of industrious, high-APRA advertisers. Our strategy accelerates the larger trend across the real estate agent industry of high producing agents crowding out those who are less competitive.

Moving now to our financial results.

Total revenue for the third quarter increased 13 percent year-over-year to \$176.8 million, from \$155.8 million in the same period last year. If we exclude Market Leader from both years, total revenue increased 18 percent year-over-year to \$165.8 million from \$140.3 million in the same period.

Looking at our primary revenue category: marketplace revenue was \$153.2 million, representing an increase of 22 percent year-over-year. Excluding Market Leader, marketplace revenue would have grown 29 percent year-over-year. Marketplace revenue now accounts for 87 percent of total revenue as compared to 80 percent during the same period last year.

Taking a closer look into our real estate subcategory, which includes our agent advertising, agent services, StreetEasy, and rentals advertising revenue, our third quarter real estate revenue reached \$129.7 million and grew 27 percent year-over-year.

Moving now to mortgages, our revenue reached \$12.6 million, which represents a 60 percent increase year-over-year. Loan requests grew 61 percent, on an as reported basis, to more than 11 million submitted during the third quarter.

In our display category, revenue was \$23.5 million, down 23 percent over the same period last year, and in line with our expectations. This downward trend continues and is intentional as we move away from display revenue and focus on the consumer experience and more valuable content based advertising. Display now accounts for 13 percent of total revenue as compared to 20 percent during the same period last year.

Before discussing our operating expenses in detail, I would like to go over three main factors that contributed to our third quarter EBITDA result of \$29.5 million, which was significantly ahead of our prior outlook. The largest impact to EBITDA came from our combination with Trulia, and was primarily related to headcount efficiencies across sales & marketing and technology & development. Adding to this was continued effectiveness of our advertising spend on our brand portfolio. Similar to what we experienced in the second quarter, we met our near- and long-term audience growth and awareness goals on Zillow at lower-than-planned advertising spend levels. Lastly, the downside risk scenarios that were baked into our Q3 outlook did not materialize during the transition of our agent advertising platform. In short, not only did the Trulia integration go faster than expected, it went much more smoothly than we anticipated.

With that, let's take a deeper look at our operating expenses by line item.

Our cost of revenue during the quarter was \$16.5 million, or 9 percent of revenue.

Next, sales and marketing expense was \$82 million, or 46 percent of revenue, which was lower than internal forecasts, reflecting cost savings related to headcount efficiencies as we unified the Zillow and Trulia sales teams. Additionally, as in the second quarter, we experienced cost savings in brand advertising spend due to greater campaign effectiveness at meeting long and short term audience goals for the Zillow brand.

Technology and development costs in the third quarter were \$53.7 million, or 30 percent of revenue, which was lower than internal forecasts, due to cost savings related to headcount efficiencies, higher capitalized wages due to the speed of integration, and contingency related expenses not being utilized.

G&A costs in the third quarter were \$42.7 million, or 24 percent of revenue, which was slightly lower than our internal forecast. The majority of G&A expenses were lower due to headcount related efficiencies stemming from the integration.

Pro forma net loss was \$21.4 million in the third quarter, compared to a pro forma net loss of \$18.6 million in the third quarter of 2014. Pro forma third quarter 2015 basic and diluted net loss per share was 12 cents, based upon 177.1 million basic and diluted weighted-average shares outstanding.

The acquisition-related costs and restructuring costs totaling \$5.4 million resulted in a GAAP net loss of \$26.0 million. GAAP third quarter 2015 basic and diluted loss per share was 15 cents. On a non-GAAP basis, which excludes share based compensation, loss on sale of a business and acquisition-related costs and restructuring costs, basic and diluted non-GAAP net earnings per share was 7 cents.

As I mentioned before, our adjusted EBITDA for the quarter was \$29.5 million, or 17 percent of revenue.

Zillow Group ended the third quarter of 2015 with over 2,100 employees; this includes our dotloop acquisition and the sale of Market Leader.

Now turning to our Zillow Group Outlook for Q4, Full Year 2015 and 2016:

Fourth quarter 2015 revenue is expected to be in the range of \$165 to \$170 million.

Our EBITDA for the fourth quarter is expected to be in the range of \$20 to \$25 million, which results in a 13 percent EBITDA margin at the midpoint of the range.

Due to the impact of our new Class C shares, our fourth quarter 2015 basic weighted-average shares outstanding is expected to be approximately 178 to 180 million and our diluted weighted-average shares outstanding is expected to be in the range of 194 to 196 million.

Turning to our full year 2015 outlook, we now expect our full year pro forma 2015 revenue to be approximately \$675 to \$680 million.

We are raising our full year pro forma EBITDA, and expect it to be in the range of \$95 to \$100 million, due to a portion of the cost savings realized in the third quarter.

We now expect full year, pro forma depreciation and amortization to be approximately \$82 million versus our prior outlook of \$90 million. The reduction was largely driven by lower amortization of web development costs.

Our full year 2015 basic weighted-average shares outstanding is expected to be approximately 169 to 171 million and our diluted weighted-average shares outstanding is expected to be in the range of 186 to 188 million.

For GAAP modeling purposes only, as we approach the end of the Trulia integration, we can reconcile outstanding one-time items definitively; thus, we now expect full year 2015 acquisition-related costs to be approximately \$16 to 18 million and restructuring-related costs to be approximately \$35 to \$36 million versus our prior outlook of \$20 million and \$31 to \$33 million, respectively.

Finally, I will recap our preliminary full year 2016 outlook. Building upon our combined scale, we are targeting a higher total revenue growth rate in 2016 than the 2015 revenue growth rate, which we expect to be 18 percent year-over-year with Market Leader and 24 percent year-over-year without Market Leader. We are prioritizing revenue growth over EBITDA expansion as we invest in our growth to capture our large opportunity ahead.

In summary, our third quarter was strong even as we balanced execution with the transition of our agent platform. We are proud of our team's execution during this year of transition and we are pleased that the flux associated with integration will be isolated to 2015. Now that the integration has been successfully completed, we are excited about the opportunities for audience engagement, product innovation, transaction innovation and revenue growth in 2016. With that we will open the call to questions.

POST Q&A

We are looking forward to closing out 2015 on a positive note with the foundation for growth in place. We are done with the integration – a huge accomplishment. Earlier in the year we combined our rentals and mortgages marketplaces, our operations and back of house services and our display business. This quarter, we laid the final stone in the foundation with the transition of our agent advertising platform to one set of ad products. Now that we have the building blocks in place, we are focused on realizing the benefits of running this business at scale. We still have a lot of work to do, but we are set up nicely for 2016 and beyond.