

## **ZILLOW, INC. Q1 2013 EARNINGS – PREPARED REMARKS**

MAY 7, 2013

### **Raymond Jones, IRO:**

Thank you. Good afternoon and welcome to Zillow's first quarter 2013 earnings conference call. Joining me today to talk about our results are Spencer Rascoff, Chief Executive Officer, and Chad Cohen, Chief Financial Officer.

Before we get started, as a reminder, during the course of this call we will make forward-looking statements regarding the future events and the future financial performance of the Company. We caution you to consider the important risk factors that could cause actual results to differ materially from those in the forward-looking statements made in the press release and on this conference call. These risk factors are described in our press release and are more fully detailed under the caption risk factors in our Annual Report on Form 10-K for the year ended December 31, 2012 and in our other filings with the SEC.

In addition, please note that the date of this conference call is May 7, 2013, and any forward-looking statements that we make today are based on the 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 present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. In our remarks, the non-GAAP financial measure adjusted EBITDA will be referred to simply as EBITDA, which excludes share-based compensation.

This call is being broadcast on the Internet, and is available on the Investor Relations section of the Zillow website at [investors.zillow.com](http://investors.zillow.com). A recording of this call will be available after 8:00 PM Eastern Time today. Please note that, the earnings press release is available on our website, and after the call, a copy of today's prepared remarks and a new historical exhibit of our business metrics will also be available on our website. After management's remarks we will host a live question and answer session.

During the Q&A we will entertain questions asked via Twitter and Facebook, in addition to questions from those dialed into the call. Individuals may submit questions via Twitter using hashtag #ZEarnings to the @zillow Twitter handle, or to the official Zillow Facebook page.

I will now turn the call over to Spencer.

**Spencer Rascoff, CEO:**

Welcome. Today we'll be discussing our first quarter 2013 performance. I'd also like to extend our thanks to those of you who joined our first-ever Investor Day in March. We were grateful for the opportunity to speak at length with you about Zillow's strategy and results.

To start off, I will briefly cover a few highlights from the quarter. Next, I will give an update on our priorities for 2013, which consist of: 1) growing our audience, 2) growing our Premier Agent business, and 3) growing our Emerging Marketplaces. Then, Chad will provide more detail on financial results, as well as give our guidance for the second quarter and full-year.

The first quarter of 2013 was a breakout one for Zillow, with record results in traffic, revenue and growth in our Premier Agent and mortgage businesses as well as the launch of our home improvement business "Zillow Digs". During the quarter, we attracted more than 50 million monthly unique users for the first time, widening Zillow's category leadership and marking a significant milestone. Traffic growth accelerated even more in April, hitting more than 52 million unique users, and year-over-year growth of 63 percent. Total revenue for the first quarter reached \$39.0 million, up 71 percent year over year and ahead of our outlook by \$2.5 million, driven primarily by the record addition of 4,557 Premier Agents in the quarter. This was the largest ever net quarterly adds for our Premier Agent business. As a result of strong sales, EBITDA reached \$5.1 million, as most of the revenue upside flowed through to our bottom line. We are pleased with our fast start to the year.

I'll turn now to our priorities for 2013, starting with growing our audience. As I mentioned, we reached a significant landmark in March and April, as we exceeded 50 million monthly unique users across mobile and Web. For perspective, it took us four years from our initial launch to get to 10 million monthly unique users. Now just three years later we've surpassed 50 million.

The emergence of mobile as the medium of choice for real estate consumers continues to catalyze our business. We invested in mobile ahead of the curve. As a result, we have meaningful market leadership. Today, 55 percent of visits to Zillow occur on mobile devices, which jumps to more than 60 percent on weekends. In April alone, more than 241 million homes were viewed on Zillow Mobile, or 93 homes per second. According to Experian, which measures mobile Web traffic for the category, Zillow's mobile Web audience is more than twice the size of the nearest competitor and more than four times the size of the third-place competitor.

And on the desktop, we continue to widen our lead as the largest real estate website, with accelerated growth in the first quarter. According to comScore, Zillow's unique users grew substantially during the quarter, while the nearest website competitors stayed essentially flat.<sup>i</sup>

What ultimately attracts such a large audience, and drives our growth, is a maniacal focus on consumer products, starting with our living database of more than 110 million homes. We have made significant

strides in the past year to strengthen this database with more than one million listings that often can't be found in an MLS, or on other real estate websites. For example, buyers on Zillow can search and find homes for sale by owner, foreclosed homes, pre-foreclosures and Make Me Move listings. Access to more potential homes for sale is incredibly important to buyers in this inventory-constrained housing market. We have also made significant improvements in the timeliness and accuracy of traditional listings inventory, including updating hundreds of MLS feeds multiple times each day and adding dozens of new brokerage partners to our Zillow Pro for Brokers program which improves listings accuracy.

Additionally on the product side, we recently upgraded and relaunched our mobile apps on iOS and Android with substantial enhancements to the user experience, including a complete redesign on iOS and a 3D map shopping experience on Android. Across seven mobile platforms, we now have 24 apps for consumers and professionals that address all points in the lifecycle of homes and span our family of home-related brands.

In addition to great product, distribution partnerships are important to growing our audience and solidifying Zillow as the destination for home shopping and a testament to our value proposition as new partners continue to seek us out. Recently, we launched three new distribution partnerships. First, we launched with HGTV's Frontdoor.com, whereby we power their real estate search. Second, we were selected by Google to be a launch partner and are currently their only real estate partner for their new predictive-search experience on Android phones, called Google Now. And most recently, Zillow began powering real estate information and search on AOL's Patch, a network of more than 900 community news and information sites visited by 13 million unique users each month. These new partnerships, alongside the Yahoo!-Zillow Real Estate Network, provide unparalleled reach for our advertisers and Premier Agents. Note that the 50 million unique users' stat does not include the full reach provided by these partnerships as we do not include Yahoo! or other non-Zillow-owned sites in that metric.

With continued product improvement and broadening distribution we've been able to continue our substantial audience growth and widen our category leadership. However, as we explained at our Investor Day, we see a significant opportunity in front of us to grow brand awareness and traffic. While we are the largest mobile and Web player in our category, our unaided brand awareness still is only about 12 percent. Put another way, 88 percent of Americans can't come up with Zillow when asked to name a real estate-related website and 27 percent of Americans can't name any brand at all – not one. This "brand white space" is unmatched in just about any other Internet or mobile category.

Seizing this opportunity, we began our first limited test of brand advertising late last year, specifically television advertising, to understand what impact this could have on our business. The initial test showed promising results, so we ran a larger, more involved test in the first quarter of this year, increasing the scope and scale of TV and testing other complementary brand advertising channels. We measured this test with the same analytical rigor we use on all areas of our business and saw statistically significant increases in high-value traffic and home shopper engagement all the way down our measurement funnel, including a halo effect of making all our other unpaid and paid marketing activities perform even better. Based on our Q1 results, we believe convincingly that advertising is working for

Zillow. It is driving increased brand awareness which will create long-term benefits, and it is increasing the quality and quantity of leads we provide to our advertisers which yields near-term benefits. The test's results, in addition to our strong organic momentum and business optimism give us the confidence to step on the gas, to go after that brand white space. Therefore, we have made the decision, that starting in the second quarter and through the remainder of the year, we are almost doubling our planned advertising spend across a number of channels, increasing it by an additional \$10 to \$15 million this year. We'll also be taking up our full-year revenue guidance from a midpoint of \$167.5 million to a midpoint of \$180 million. While this incremental investment directly impacts our EBITDA levels in the near term, we believe firmly that advertising will allow us to achieve greater revenue scale more rapidly.

Now onto our second priority for 2013: growing our Premier Agent business. We made excellent headway during the quarter, adding nearly 4,600 new Premier Agents for a total of more than 34,000 subscribers. Also, we completed the transition to selling a fixed number of impressions. Our team executed this transition to align our inventory with our traffic growth. So now when traffic increases, we have more impressions available to sell.

Next, to further benefit our Premier Agents, we just released two frequently requested enhancements to the free CRM we provide to Premier Agents. First, with our new lead-forwarding rules, agents can set up automated responses and email rules to better manage their leads. Next, with our new email functionality, Premier Agents can keep their clients and potential clients informed with market updates and saved-search notifications that automatically send new listings as they hit the market. These enhancements to our CRM – and the individualized websites we provide for free to Premier Agents – were made possible by our acquisition of Diverse Solutions, which now connects to more than 390 MLSs (up from about 130 MLSs at the time of our acquisition 18 months ago).

Looking now at our third priority this year - growing our emerging marketplaces - we continue to gain meaningful traction in our mortgage and rental businesses.

In Zillow Mortgage Marketplace, we have made exciting progress for both consumers and mortgage providers. This quarter we integrated Zillow Mortgage Marketplace into all of our Zillow mainline mobile real estate apps. Mobile now accounts for 31 percent of Zillow Mortgage Marketplace revenue. We now also offer mortgage quoting for underwater borrowers seeking refinancing – this new feature is unique to Zillow and especially valuable to the large number of homeowners with negative equity, which Zillow economists estimate to be 27 percent of homeowners with a mortgage. Zillow is now the only destination for consumers to find refi quotes for underwater borrowers, which is beneficial to both our consumer and professional audiences.

Next in our Rentals Marketplace, during the quarter we launched new rentals apps on Android and iPad that were both featured in their respective app stores with the new Android app supporting Spanish language. Rental shopping skews heavily towards mobile and our investment there is paying off. On

listings count, the majority of our more than 600,000 rental listings are now sourced via direct relationships with property managers and landlords, which differentiates us from competitors.

We remain on track for greater focus on monetization in our Rentals Marketplace late this year and into 2014. We anticipate a hybrid approach tailored to the different segments of the rental market that both encompasses the sale of advertising as well as software-as-a-service technology tools.

Finally, the entry into our newest marketplace of home improvement has gone well so far. After the launch of Zillow Digs in February, during which Apple featured the app, we have seen terrific uptake in user generated content with more than 54,000 total photos and 90,000 content boards.<sup>ii</sup> Notably, the Zillow Digs iPad app experiences 10 times the page views per session versus the Desktop – a strong validation of our mobile-first strategy. We are diligently working to grow usage of Zillow Digs and will focus on monetization down the road.

In each of our four distinct yet interconnected marketplaces – Real Estate, Mortgages, Rentals and Home Improvement – Zillow is making significant investments now which plant seeds for the future. We are digging our own wells here rather than outsourcing these adjacent verticals to third parties and going for short-term profit. We are playing the long game.

Similar to our increased commitment to advertising, we are making investments in each of our four marketplaces which delay short-term margin in favor of long-term value creation.

First, investing in software tools for our core Premier Agent marketplace makes us more valuable to our Premier Agents, increases advertiser retention and allows us to achieve a larger portion of the almost \$10 billion a year agents spend to market themselves. Second, investing in our emerging marketplaces takes our addressable market from around \$10 billion with agents to \$35 billion when including mortgages, rentals and home improvement. Third, investing in advertising helps us achieve greater traffic and mindshare leadership for consumers and advertisers. When you look across other online media companies, category leaders are able to achieve significant revenue leadership because they become a “must-buy” for advertisers.

Q1 was a breakout quarter for Zillow as we reached new heights in our audience and revenue, and continued to extend our lead on mobile and Web. We remain focused on our three strategic priorities this year of growing our audience, growing our Premier Agent business and growing our emerging marketplaces. We are very pleased with our progress, but are still very early with much to do.

With that I will turn the call over to Chad.

**Chad Cohen, CFO:**

Thanks Spencer.

First-quarter traffic grew 47 percent year-over-year to 46.7 million average monthly unique users and peaked in March at 50 million. As Spencer mentioned, traffic continued to grow even more into April with year-over-year growth accelerating to 63 percent during that month. We posted Q1 total revenue of \$39.0 million, a record, and up 71 percent year over year.

One modeling note – remember that growth in our audience does not immediately translate to new Premier Agent revenue, rather it works gradually into our results. As traffic grows and becomes sustained, new impression inventory is created. New inventory can then be sold in subscriptions to existing or new Premier Agents, which then becomes recognized as impressions delivered over the life of a contract and beyond.

Compared to our outlook, we exceeded the \$36.5 million mid-point of our range by \$2.5 million, driven primarily by outperformance in our marketplace category.

Marketplace Revenue reached \$31.0 million, representing 87 percent year-over-year growth and 80 percent of total revenue. To provide increased transparency and for a better understanding of our business, in our SEC filings starting with this reporting period, we are now presenting two sub-categories within the Marketplace Revenue category, consisting of Real Estate and Mortgages.

Taking a deeper dive into our Real Estate Marketplace Revenue, made up of Premier Agent, Diverse Solutions and Rentals businesses, revenue was \$26.1 million in the quarter and grew 84 percent year over year. The primary driver of growth was our Premier Agent business, where we added 4,557 Premier Agents in the quarter, with a net increase of 15,414 Premier Agents from this time last year.

Average monthly revenue per subscriber, or ARPU, was \$259 in the quarter, and represented a 2 percent decrease from last year and 3 percent decrease sequentially from the previous quarter. The slight ARPU decline is primarily related to the record number of new adds, as new Premier Agents typically start their subscription levels lower than our average as well as timing of many net new adds later in the quarter. As a reminder, the ARPU metric is an output and not something by which we run the business, as our inventory model allows agents to purchase impressions at an amount based on their budget and at prices that are determined by local market dynamics.

Moving now from Real Estate to our Mortgages Marketplace, which consists of our B2C Zillow Mortgage Marketplace and our B2B Morteck business, revenue reached \$4.9 million and grew 104 percent year over year. During the quarter, 4.5 million loan requests were submitted to Zillow Mortgage Marketplace, growing 74 percent over last year's figure. The vast majority of loan requests submitted were for purchase loans as opposed to refinancing.

Looking now at our Display Revenue, revenues were \$7.9 million, up 27 percent year over year, representing 20 percent of our total revenue. Our display business continues to complement our marketplace strategy, and delivers a strong contribution margin.

Moving on to our expenses, total operating expenses were \$42.8 million in the first quarter as compared to \$21.1 million in the same quarter last year. The increase in expenses versus last year is primarily due to: 1) growth in headcount related expenses reflecting an increase from 380 employees to more than 600 employees and 2) increased advertising investments. Our OpEx increase year over year would have been closer to 80 percent excluding the advertising increase.

Now I'll touch briefly on each major expense line item, starting with cost of revenues. For the first quarter our cost of revenues was \$4.1 million or 11 percent of revenues, as compared to \$3.4 million or 15 percent of revenue in the same period last year. The leverage reflects higher levels of engagement of Zillow-owned-and-operated properties versus our partners, which is accounted for in our revenue sharing agreements, combined with the fixed costs of operating our platform.

Next, sales and marketing expenses, which include our Premier Agent sales team, marketing team and advertising activity, were \$19.8 million or 51 percent of revenue, as compared to \$8.3 million or 36 percent of revenue in the same period last year. A large part of the variance from last year resulted from our increased investments across advertising channels to support our long-term growth objectives, which resulted in a broadly positive signal related to the growth in our audience, greater shopper engagement and increased buyer activity.

Technology and development costs were \$10.6 million or 27 percent of revenue, compared to \$5.0 million or 22 percent of revenue last year. The increase in expenses was driven by the increase in our engineering team headcount and ongoing product initiatives in both our organic and acquired operations.

Lastly, G&A costs were \$8.2 million or 21 percent of revenue, as compared to the same period in the prior year at \$4.4 million or 19 percent of revenue, driven by incremental headcount, professional services and facilities to support our growth.

Turning now to profitability, our EBITDA for the quarter was \$5.1 million, representing 13 percent of revenue. This result exceeds our guidance midpoint by \$1.9 million, due to the beat on revenue.

On a GAAP basis, net loss for the quarter was \$3.7 million, representing a GAAP loss per share of 11 cents for basic shares of 34 million.

We ended the quarter with approximately \$204 million in cash and cash equivalents as well as short- and long-term investments. We currently have no debt and our credit lines remain untapped.

Now I'll discuss our outlook, starting with the second quarter 2013.

In the second quarter, as a result of our successful transition to fixed impression based contracts, and projected growth in our mortgage and display businesses, our revenue is expected to be in the range of \$43.5 to \$44.5 million, which represents 58 percent year-over-year growth at the midpoint of the range.

Our EBITDA for the second quarter is expected to be approximately \$750 thousand to \$1.25 million. During the second quarter, we anticipate an incremental investment in advertising of \$4 to \$5 million, above our previously planned levels of around \$5 million, which directly impacts our EBITDA versus our prior plan.

Looking closely at the Sales and Marketing line item in the second quarter, which encompasses all of our sales, marketing and advertising activity, we anticipate recording total expenses of \$34 to \$35 million for the period. Included in this line will be a one-time, non-recurring stock-based compensation charge of approximately \$7 million due to an acceleration provision related to a prior acquisition. While this non-cash expense does not impact our projected EBITDA results, it does affect the amount of Sales and Marketing expense recorded in our income statement.

Looking at the projected reconciling figures to EBITDA, total stock based compensation in the second quarter is expected to be in the range of \$10.0 to \$10.5 million, and depreciation and amortization expenses are expected to be in the range of \$5.0 to \$5.5 million. Although we do not provide a GAAP EPS outlook, we expect a basic weighted average share count of approximately 35 million shares for the quarter.

For full year 2013, we anticipate total depreciation and amortization expenses for the year to be in the range of \$23 to \$24 million, share-based compensation to be in the range of \$22 to \$24 million and CapEx and capitalized data content to be in the range of \$10 to \$13 million. We expect fourth-quarter 2013 basic- and diluted-share counts to be 36 million and 39 million weighted-average shares, respectively.

Moving to Sales and Marketing: we are projecting approximately \$96 to \$98 million in total expense for the year, which includes approximately \$3 to \$4 million of stock-based compensation, but excludes the one-time stock charge. Previously we provided an outlook for 70 percent year-over-year growth in this expense line, which translated into a mid-\$80 million range for these expenses inclusive of stock-based compensation. The increase from a mid-\$80 million range to an upper-\$90 million range is the incremental ad spend we've already discussed.

Based on our performance in the first quarter, in addition to our Q2 guidance, we are raising our full-year-revenue guidance, which we now expect to be in the range of \$178 to \$182 million, representing 54 percent year-over-year growth at the midpoint of the range. Consistent with recent results, we expect the favorable mix shift from Display to Marketplace Revenue of a few percentage points to continue year over year.



As a result of our strategic decisions on how we will run the business, we now expect approximately \$20 million in full year EBITDA. Looking back to February when we first provided our outlook for 2013, we projected that EBITDA as a percent of sales would be flat to down compared to last year. From our previous revenue guidance this translated into a low- to mid-\$30 million range for EBITDA. Most of the reduction in full-year 2013 EBITDA comes from the decision to increase advertising by \$10 to \$15 million.

In conclusion, we are quite pleased with our first-quarter numbers. We achieved record results in traffic and revenues, widened our traffic lead versus competitors and began to step up our strategic investments in the long term. We are still in very early days as we pursue the massive market opportunity in front of us and we remain focused on growing our audience, growing our Premier Agent business and growing our emerging marketplaces on mobile and the Web.

Thank you for your time today. With that, we would like to open up the call for questions. I'd also like to remind you that for the first time, we will be considering questions submitted via Twitter, with the hashtag #ZEarnings.

#### **SPENCER AFTER Q&A**

We'd like to thank you all for owning and supporting Zillow as we accelerate our drive to create a ubiquitous brand and a highly profitable business long term in a huge and open vertical marketplace, real estate. The further we get in this Zillow adventure the larger the long-term opportunity looms and the better positioned we are to capture it.

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<sup>i</sup> comScore Media Metrix, Real Estate Category, Unique Visitors, January-March 2013, U.S. data. Trulia.com and Realtor.com were both up 0.9% from Jan to March 2013, while Zillow.com was up 16.3%.

<sup>ii</sup> The data included in this sentence has been corrected since 05/07/2013.