

ZILLOW, INC. Q2 2013 EARNINGS – PREPARED REMARKS

Aug. 6, 2013

Raymond Jones, IRO:

Thank you. Good afternoon and welcome to Zillow's second 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 Dec. 31, 2012 and in our other filings with the SEC.

In addition, please note that the date of this conference call is Aug. 6, 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. A recording of this call will be available after 8 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 prepared remarks and historical exhibit of our business metrics will also be available on our website. After management's remarks we will host a live question and answers 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 by tweeting @Zillow using the #ZEarnings hashtag, or to the official Zillow Facebook page.

I will now turn the call over to Spencer.

Spencer Rascoff, CEO:

Thank you for joining us to discuss Zillow's second quarter performance.

Today I will start with highlights from our results in the quarter, and then give a mid-year update on our 2013 strategic priorities of growing our audience, growing our Premier Agent business and growing our emerging Marketplaces. I will then turn the call over to Chad to discuss our financials and our outlook in more detail. And we'll, of course, open up the call for questions from dialed-in participants and our social media audience on Twitter and Facebook.

Zillow had a tremendous second quarter, achieving record revenue, which led to an EBITDA result that exceeded our plans.

Our total revenue for the quarter was almost \$47 million – up 69 percent year over year – driven by strong performance across the board in our Marketplace and Display revenue categories. In our Marketplace category, both our real estate and Mortgage businesses saw their positive momentum continue. We added almost 4,800 Premier Agents during the quarter, which was an all-time high for quarterly net-adds. In our Mortgage business, revenue neared \$6 million as we continued to gain traction on both the consumer and professional sides of the marketplace. Our Q2 run rate for total Marketplace revenue was about \$157 million, which is nearly double this time last year.

Meanwhile, our Display revenue category showed excellent growth of almost 30 percent year over year, despite macro challenges in the Display advertising industry stemming from the proliferation of programmatic ad exchanges. Much credit goes to our Display sales team, adding new advertisers as well as increasing spend levels from our existing advertisers.

As a result of our strong sales, combined with the high operating leverage inherent in our model, our EBITDA exceeded \$5 million for the quarter. From the top- to the bottom-line, Zillow is firing on all cylinders. I'm extremely proud of the team and our performance this quarter.

Turning now to our strategic priorities: When I laid out our three priorities for 2013, I said No. 1 was to grow our audience. We are pleased to announce that during the month of July, we hit a significant milestone of more than 61 million unique users on mobile and the Web during a single month, representing 24 million net adds year over year, or 66 percent growth. It was just last quarter that we topped 50 million uniques for the first time.

To put our audience growth into perspective, during just the past year, we added the equivalent in unique users of almost an entire Move, Inc., or two-thirds of a Trulia. This is based on unique user counts that both brands self-published in their Q2 reports. This is staggering growth in just the past year.

We all know the future is mobile, and we have even more market-share leadership on mobile than on the desktop – 60 percent of our visits now come from a mobile device. In fact, mobile visits have nearly

doubled year over year, and, in July, 120 homes were viewed per second on mobile, compared to 63 per second last year.

Our growth always begins with our product and our focus on empowering consumers with the best experience possible. A few recent product innovations include a new shopping search filter by school type on desktop, and our new Foreclosures In-Market Guide on home details pages that incorporates more foreclosure data with our analytics to help buyers get an edge. Some of our product design inspiration gets channeled into our semi-annual Hackweek, and we completed another great one in June, where we saw some excellent new ideas from our very creative product teams. For more details on what Hackweek is all about, as a social supplement to this earnings call, we just posted new information to Facebook to give everyone a better sense of our culture of innovation and creative work environment.

Also supporting our audience growth, we continued our investment in brand advertising this year, which we outlined for you last quarter. We launched a second TV spot in June, called “Long Distance”, which you can view at [Zillow.com/tv](https://www.zillow.com/tv). We now have two TV spots airing nationwide across major cable networks.

We believe in brand advertising as a long-term investment to build an enduring brand and household name. However, like everything at Zillow, we voraciously measure all of our advertising channels through our full funnel metrics, and we are constantly analyzing and optimizing our spend. After less than two quarters of advertising, we are very pleased with the results we’ve seen.

At the top of the funnel, we have seen a noticeable lift in our traffic that we can attribute to our advertising, and, as a result, we are taking market share in the category. Since Jan. 1 of this year, we have more than doubled our lead in real estate category market share over our closest competitor – as defined by comScore Media Metrix Multi-Platformⁱ. Zillow now represents almost one-third of the category desktop unique users, with a substantial lead versus the closest competitors.

More important than raw audience growth is growth in shoppers and shopping activity. Our advertising attracts serious home shoppers, which is evident in all of the engagement metrics we track, including increased views of homes for sale and time spent home shopping per user. Importantly, while our audience growth rate has been more than 60 percent each month in Q2, contacts to Premier Agents have grown even faster, showing year-over-year growth rates above 80 percent. The investment in our brand as well as in tech and development is resulting in accelerating trends all the way down the shopping funnel.

And while building brand awareness is a multi-year endeavor, we have also seen early positive signs in consumer awareness of Zillow. Since the start of the year, Google Trends (which measures search volumes for various terms on Google) reports that searches for the word “Zillow” have increased 61 percent, while real estate searches have grown only 16 percent, and searches for the brand names of our two closest competitors grew 16-18 percent.ⁱⁱ

As we've said for the past few quarters, investing in our brand today is part of our long-term strategy. We believe in the primacy of audience – that whichever model serves the consumer the best, establishes the largest household brand, and wins the largest sustained audience, ultimately will take the lion's share of the media revenue available in our category. This is the story of online media leaders in category after category – the audience leader tends to end up with most of the revenue and profits.

Audience leadership is the most important thing to attract advertisers. But it's not enough. We also believe that providing software tools for our advertisers is important.

This leads us to our second priority for the year: growing our Premier Agent business. We now have more than 38,000 Premier Agents, with record growth in net adds during the quarter.

In addition to growing our agent count, we launched a number of products and benefits to provide more value for existing Premier Agents.

As a result of our Buyfolio acquisition last year, we recently began the roll out of Agentfolio, a private and collaborative mobile and Web-based shopping experience for Premier Agents and their clients. Agentfolio enhances the value of an agent in the shopping process, while providing a terrific user experience for home shoppers and ultimately helps agents communicate better with their clients and close more deals. The service is free for Platinum Premier Agents and can be purchased separately by non-Premier Agents for a monthly fee. Agentfolio is now live in six major markets and we plan to roll it out to five additional cities by the end of the year. Reception from our Premier Agents so far has been very positive.

The listings inside Agentfolio come from MLSs and are powered by Diverse Solutions, our 2011 acquisition that expanded Zillow into the agent website business. This is a great example of our M&A strategy – we bought two small software companies, one in New York and one in Irvine, each for less than \$10 million. And through our successful integration we were able to launch incredibly disruptive MLS-powered websites (available for free to Premier Agents), which Inman News awarded us "Innovation of the Year" last year. Now we are able to roll out another free tool for Premier Agents – Agentfolio.

Additionally during the quarter, we launched a new efficient way for agents to partner with mortgage lenders in their market, called our Premier Agent Lender program. A common practice in the industry is for individual real estate agents and mortgage lenders to refer clients to each other as well as co-market their services together. Our new Premier Agent Lender program lets Premier Agents endorse a lender that they prefer on Zillow and, in turn, allows for the lender to subsidize or grow the Premier Agent's advertising subscription. We're very excited about the potential of this program and the value it adds for Premier Agents.

Now I'll move on to our third strategic priority for the year: Growing our emerging Marketplaces – mortgages, rentals and home improvement.

Starting in our mortgage business, revenue grew more than 100 percent year over year, with consumers submitting an average of 1.7 million loan requests each month, up 86 percent year over year.ⁱⁱⁱ Our consumer experience is unparalleled in the industry, with anonymous potential borrowers receiving more than 30 personalized quotes per loan request.^{iv} We continue to believe that drilling our own well in mortgages is the right long-term strategy, giving us complete control to build the best consumer experience possible. It also significantly lessens any impact of rising mortgage rates on refinance business, as the vast majority of Zillow Mortgage Marketplace users are buyers seeking purchase loans. On the lender side of the Marketplace, our Mortech product suite, which includes the best-in-class CRM and Product Pricing Engine for the industry, continues to perform very well. We are pleased with our lender pro tools revenue growth and contribution margin. The Mortech acquisition – seven months post-closing – has played out as we'd hoped, providing a suite of software tools for lenders to improve the ROI on their Zillow spend, and makes Zillow a more important partner to the lender.

As for our Rentals Marketplace we continue to make good progress in building out our consumer and professional sides. We're investing significantly in development on both of our consumer rental brands – Zillow and HotPads, focusing on listings volume, freshness and quality. Zillow.com serves nearly 10 million rental shoppers on the Web each month. And audience growth is good for the professional side of our Marketplace, as individual contacts to property managers have grown 80 percent year over year.

About six months ago we shared that we expected to begin monetizing the Rentals Marketplace in late 2013, and we are on schedule. Just last month we began selling featured properties for multi-family property managers, which allows premium placement in local search results on Zillow and HotPads. While we don't expect a material impact on 2013 results, we believe that our substantial rental lead volumes and our sales strategy position us well for rentals revenue in 2014. The rental advertising TAM for multi-family apartment buildings is more than \$6.6 billion, to say nothing of the single-family opportunity. There is a big business to be built here, and we are focused on building it.

And in our newest Marketplace, our home improvement product Zillow Digs, we continue to grow our consumer offering and audience, although this product remains in the very early stages. Most recently, we launched an innovative way for users to identify and match the paint colors seen in thousands of photos to find real paint colors in stores as well as search our photos by color palette. We will continue to grow consumer audience here, and focus on revenue down the road.

All in all, a tremendous performance across all of our strategic priorities, and all of our home-related Marketplaces this quarter.

Before concluding my remarks, I am going to take a moment to update portions of our outlook, and briefly discuss the event we are hosting with President Barack Obama tomorrow.

Regarding our outlook, we now project our revenue for the full year 2013 to be in the range of \$186 to \$188 million, up 60 percent year over year at the midpoint. While this is an increase of about \$7 million over the midpoint of our previous range, we are holding our projection for EBITDA at \$20 million for the year, and investing the difference back into the business. As we continue to receive positive signals from our brand advertising, we become more excited about the opportunity - and strategic focus - we've chosen in creating a lasting consumer brand for the long term. We will continue to invest substantially in product development and brand advertising this year.

Finally, we are extremely excited about tomorrow's event that Zillow is hosting with President Barack Obama. The team at Zillow is collecting questions from homeowners, renters and prospective buyers via social media, and tomorrow I'll present some of those questions to the President in a live event. Zillow exists to help people become smarter about what's often the largest purchase of their lifetime – their home. This is an unprecedented opportunity for users to ask their housing questions to the president of the United States. More details on the event can be found at Zillow.com/WhiteHouse.

In conclusion, when considering the enormous opportunities in front of us, we are thrilled with our position in the long game. We remain excited and determined to extend our category lead by focusing on our strategic priorities and planting seeds for long term growth. We still are in the early days with much to do.

With that I will turn it over to Chad.

Chad Cohen, CFO:

Thanks, Spencer.

After going through our financial results for the second quarter, I will also address the outlook in further detail that Spencer briefly touched on, and then we'll open up the call for questions.

Overall this was a great quarter for Zillow. Starting with traffic, second quarter traffic grew 62 percent year over year to 54.3 million average monthly unique users, peaking in June with approximately 56 million, and then topping that again in July with more than 61 million.

Next, second quarter revenue totaled a record \$46.9 million, up 69 percent year over year. Compared to our outlook, we exceeded the \$44.0 million midpoint of our range by \$2.9 million due to terrific performance in both our Marketplace and Display revenue categories.

Marketplace revenue reached \$36.5 million, representing 86 percent year over year growth and 78 percent of total revenue.

Taking a closer look at our real estate Marketplace revenue subcategory, which is made up of our Premier Agent, Diverse Solutions and rentals businesses, revenue was \$30.6 million in the quarter and grew 80 percent year over year. The primary driver of growth was our Premier Agent business, where we added a record 4,777 Premier Agents in the quarter, with a net increase of 16,111 Premier Agents from this time last year. This represents a slight acceleration of our Premier Agent net adds from this time last year when we grew our subscribers by 70 percent. Also, as we were able to open up more impression inventory as a result of our traffic growth, more than 50 percent of our bookings during the quarter went to existing agents purchasing additional impressions, consistent with prior trends. Keep in mind that when our traffic grows additional inventory can be created and then sold in subscriptions to Premier Agents; revenue is recognized over the life of the subscription contracts.

Average monthly revenue per user, or ARPU, was \$266 in the quarter for the Premier Agent business, and represented a 1 percent increase from last year and 3 percent increase sequentially from the previous quarter. As a reminder, the ARPU figure is an output that is neither a proxy for pricing nor a metric by which we run the business. Our inventory model allows agents to purchase available impressions at prices that are determined by local market dynamics and at an amount based on their budget.

Moving now from real estate to mortgages, which consists of our Zillow Mortgage Marketplace and our Mortech software business, revenue reached \$5.8 million and grew 126 percent year over year. During the quarter, 5.3 million loan requests were submitted to Zillow Mortgage Marketplace, growing 86 percent over last year, an increase over the Q1 growth rate of 74 percent. The vast majority of loan requests submitted were for purchase loans as opposed to refinancing.

Turning to our Display category, revenue was \$10.5 million and increased 29 percent year over year which is the third consecutive quarter of accelerated growth. These gains were broad-based, with healthy growth across most of our primary Display verticals including builders, banking and brokerages. Our Display business represented 22 percent of total revenue this quarter and continued to deliver a strong contribution margin.

Moving on to our expenses, total operating expenses were \$57.3 million in the second quarter as compared to \$26.5 million in the same quarter last year. The \$30.8 million increase in expenses versus last year was primarily due to three factors: 1) increased headcount-related expenses reflecting growth from over 440 employees to just under 700 employees, with approximately 25 percent of the year-over-year increase in our employee base resulting from our acquisitions; 2) increased advertising investments to grow our audience; and 3) as outlined in the 10-Q we filed on May 8, a one-time \$7.1 million acceleration of stock-based compensation related to a prior acquisition. Our OpEx increase year over year would have been closer to 60 percent, or \$15.3 million, if we were to exclude the advertising increase and one-time expense.

Now I'll go into a few details briefly on each major expense line item, starting with cost of revenue.

For the second quarter our cost of revenue was \$4.3 million or 9 percent of revenue, as compared to \$3.3 million or 12 percent of revenue in the same period last year. Leverage came from two sources: 1) higher levels of engagement with Zillow-owned and -operated properties versus our revenue-sharing partners; and 2) fixed costs of operating our platform that allow for our scalability.

Next, sales and marketing expenses, which include our Premier Agent sales team, marketing team and advertising activity, were \$32.9 million or 70 percent of revenue, as compared to \$12.2 million or 44 percent of revenue in the same period last year. The variance from last year resulted primarily from our increased investments across advertising channels to support our long-term growth objectives. Compared to last year, advertising expenses increased approximately \$8.4 million. Also, adding to the increase in the Sales and Marketing line item was the \$7.1 million one-time stock charge I mentioned earlier. Excluding these two items, sales and marketing expenses increased approximately 43 percent year over year, and represented 37 percent of revenues.

Technology and development costs were \$11.1 million or 24 percent of revenue, compared to \$5.8 million, or 21 percent of revenue last year. The increase in expenses was primarily driven by the growth of our engineering teams that support product initiatives and higher amortization of intangibles year over year related to acquisitions. We believe that our extraordinary product development team of more than 180 people is the best in the industry. On an absolute basis and as a percent of our revenue we are investing more in technology than any real estate media company or brokerage, which helps us extend both our audience lead as well as the software tools we provide to our real estate advertisers.

Lastly, G&A costs were \$9.0 million or 19 percent of revenue, as compared to the same period in the prior year at \$5.2 million or 19 percent of revenue, driven by incremental headcount, along with increased professional services and facilities costs to support our growth.

Turning now to profitability, our EBITDA for the quarter was \$5.3 million representing 11 percent of revenue. This result exceeds our guidance midpoint by \$4.3 million, primarily due to the higher revenue than we projected flowing through to the bottom line and also due to a combination of expense timing along with better than expected efficiencies across spending areas, including marketing and headcount.

On a GAAP basis, net loss for the quarter was \$10.2 million, representing a GAAP loss per share of 30 cents for basic and fully diluted shares of 35 million.

We ended the quarter with approximately \$208 million in cash, and cash equivalents and investments. We remain debt free with our credit lines untapped and available to us.

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

For the third quarter, our revenue is expected to be in the range of \$49.5 to \$50.5 million, which represents 57 percent year-over-year growth at the midpoint of the range.

Looking at the Sales and Marketing line item in the third quarter, we anticipate recording total expenses of \$29 to \$30 million for the period. Compared to the prior year, we anticipate an incremental investment in brand advertising of \$9 to \$10 million as well as ongoing hiring in our inside sales group. We will continue to track performance of our investment in advertising very carefully in terms of the signals we monitor throughout the shopping funnel.

Our EBITDA for the third quarter is expected to be approximately \$1.5 to \$2.0 million. Looking at the projected reconciling figures to EBITDA, total stock-based compensation in the third quarter is expected to be in the range of \$3.5 to \$4.0 million, and depreciation and amortization expenses are expected to be in the range of \$5.5 to \$6.0 million. Although we do not provide a GAAP EPS outlook, we expect a basic and fully diluted weighted average share count of approximately 36 million shares for the quarter.

Now looking at full year 2013, we are raising our revenue guidance from the previous range of \$178 to \$182 million to a range of \$186 to \$188 million for the year, representing 60 percent year-over-year growth at the midpoint of the range. The increase in our revenue outlook comes from our confidence in recent trends in our three main revenue areas: Premier Agent, Mortgages and Display.

Regarding full-year Sales and Marketing expenses, we now project approximately \$100 million in total expenses for the year. This figure exceeds the high end of our previous outlook range by \$2 million, and includes approximately \$3 to \$4 million of stock-based compensation, but excludes the one-time stock charge.

As Spencer mentioned previously, we are reinvesting our near-term positive EBITDA variances back into our business, primarily into advertising. Looking back at the beginning of this year, we anticipated that we would be committing about 20 percentage points of EBITDA margin to brand advertising, and another 10 or more percentage points to develop new products and grow our Marketplaces. In the second quarter we then increased our commitment to advertising based on the compelling positive signal we received from advertising tests, and we will continue this commitment through the rest of the year. These factors have resulted in our projected EBITDA margin running below our target model this year deliberately to support our pursuit of a sustainable long-term competitive advantage in our category.

Consistent with our strategic decisions on how we will invest back into our business, we expect approximately \$20 million in full year EBITDA, which is in line with our previous outlook range. We anticipate total depreciation and amortization expenses for the year to be in the range of \$22 to \$23 million, share-based compensation also to be in the range of \$22 to \$23 million, and CapEx and capitalized data content to be in the range of \$12 to \$14 million. We expect fourth quarter 2013 basic and diluted share counts to be 36 million weighted-average shares.

In conclusion, we continue to make progress and gain momentum. We achieved record results in traffic and revenues in the second quarter and extended our traffic lead versus competitors. We remain focused on execution in growing our audience, growing our Premier Agent business and growing our emerging Marketplaces on mobile and on the Web as we aggressively attack the huge market opportunities that we address in the lifecycle of homes.

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 we will be considering questions submitted via Twitter and Facebook with the hashtag #ZEarnings.

ⁱ comScore Media Metrix Multi-Platform data, July 2013

ⁱⁱ Google Trends, July 2013