

ZILLOW, INC. Q3 2013 EARNINGS – PREPARED REMARKS

Nov. 5th, 2013

Raymond Jones, IRO:

Thank you. Good afternoon and welcome to Zillow's third 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 November 5th, 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 answer session.

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

After the call, analysts from the Motley Fool will host a brief follow up Q&A session with Spencer via Twitter.

I will now turn the call over to Spencer.

Spencer Rascoff, CEO:

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

The third quarter was an extremely strong one for Zillow. We continued to set new records in our business metrics and operating results. We also gained increasing momentum as the definitive home shopping brand for consumers. One indication of Zillow's clear category leadership was my August interview with President Obama. During that event – viewable on zillow.com/whitehouse/, President Obama answered housing questions directly from Zillow users. This first-of-its-kind conversation with the President provided him with access to the largest consumer audience in online and mobile real estate. During the quarter, Zillow's total traffic exceeded 61 million average monthly unique users, peaking for the year at nearly 64 million unique users in August, smashing records in both overall uniques and real estate shopper visits. We continue to substantially widen our traffic leadership in the category.

Total revenue for the quarter was just over \$53 million (up 67 percent year over year) -- a quarterly record that exceeded our outlook of \$50 million at the midpoint. In Q3, Premier Agent net subscriber additions approached 6,000 for the first time. We now have nearly 45,000 subscribing real estate agent advertisers. This drove our Marketplace revenue category to a new record of almost \$41 million.

Our Display revenue topped \$12 million for the quarter, and came in significantly ahead of expectations. Terrific execution by our Display team, strong advertiser relationships and our premium value proposition to advertisers drove these results, despite the challenging macro environment in display due to programmatic ad buying.

Our EBITDA for the quarter was \$4.1 million, and exceeded our outlook of \$1.75 million at the midpoint of the range. From top to bottom, we are very pleased with our results.

With another excellent quarter in the books, I'll now give an update on our three strategic priorities for 2013: 1) growing our audience; 2) growing our Premier Agent business; and 3) growing our emerging marketplaces.

Starting with our first priority, we are seeing tremendous audience growth driven by best-in-class product and advertising.

Everything we do at Zillow begins with creating amazing and immersive products on mobile and Web. With our product ship cycle of two weeks or less, we are constantly launching, iterating and improving our mobile apps and sites. In addition to major feature releases, we are constantly running dozens and sometimes hundreds of multivariate tests on both mobile and desktop, which drive repeat usage and improve site conversion.

Notable in the quarter is that we were spotlighted by Apple on stage during its iOS 7 launch. Our developers and designers completely redesigned the Zillow Real Estate App for the iPhone and iPad, resulting in a spectacular and visual product that makes home shopping even more intuitive and fun, and our thousands of glowing reviews in the App Store tell the story. Our app was one of only four chosen by Apple to be demoed at its launch event for iOS 7, and was heavily featured in the App Store for weeks afterwards. This type of recognition by Apple significantly impacts our downloads and usage, and widens our mobile lead in the category. One of our advantages on mobile is that as a technology company with a nationwide real estate footprint, we are uniquely able to take advantage of opportunities like this. Local real estate companies have neither the footprint nor the technology expertise to create and continually update apps with mass appeal.

Our category leading audience growth on mobile and Web originates from great product, which in turn gets amplified by focused marketing. We are very pleased with the investment we've made in advertising this year, and we're seeing extremely positive returns all the way down our shopping funnel, from unique users, to unique home shoppers, to contacts, to Premier Agents.

We began the year as the category leader and we've seen that lead widen substantially this year.

First, on desktop: According to comScoreⁱ, Zillow's audience market share grew from nearly 27 percent of the category to nearly 34 percent year-to-date. The No. 2 and 3 brands in the category lost share during this same period. Over the past 12 months, Zillow has more than doubled its market share lead over the second brand in the category.

Additionally, Experian Hitwise measures our mobile Web presence as nearly twice the size of the No. 2 brand in our category, and nearly four times the size of the No. 3 brand.

To put these stats into concrete numbers, at the quarter peak, we gained 27 million total monthly unique users year over year, which is the equivalent of adding almost an entire Realtor.com, or three-quarters of a Trulia. This is based on internal reporting from competitors' quarterly reports last week, including both mobile and Web.

The growth in our traffic consists of serious home buyers and renters. Continuing the trend we saw last quarter, as our traffic grew 69 percent year over year this quarter, our growth in contacts to agents again exceeded 80 percent year over year. Another metric – views of for-sale listings – is up 80 percent year over year, and we believe that Zillow is growing serious home shopper traffic faster than the category off a much larger base.

Advertising is working for us, and because we are in high growth investment mode, we expect that we will spend at least the same amount if not more in 2014. We will share more about 2014 advertising plans when we report our full-year results in February.

Another investment that contributes to our priority of growing our audience is our August acquisition of StreetEasy, the No. 1 online destination for real estate shoppers in New York City. StreetEasy draws more than 1 million monthly unique

users, and contains untapped potential to grow further as a part of the Zillow family of brands.

To understand what StreetEasy accomplished as a bootstrapped startup pre-acquisition requires a deeper dive into the New York metro market. There is no other real estate market like New York in the United States. New York is densely populated and expensive, with neither a consolidated multiple listing service for Manhattan nor one that spans the five boroughs. There are approximately \$31 billion in resale transactions across the five boroughs annually, resulting in \$1.9 billion in commissions earned by brokers in New York City. This is about 60 percent of the commission amounts earned by agents in Australia and about one-third of the commissions earned by agents in the UK. In addition, New York rental transaction volumes eclipse for-sale transactions.

To provide a comprehensive real estate site for consumers throughout the city, StreetEasy built a very specialized offering leveraging data of particular interest to New Yorkers. Over the course of the company's eight-year history, its offering beat out the competition, and StreetEasy became the clear leader in online New York real estate.

As a result of unique market circumstances and excellent execution, very powerful network effects reinforce StreetEasy's market position. We are thrilled to be combining forces to take the StreetEasy brand and product suite to the next level. As a small first step, next week StreetEasy will be integrating Zillow Mortgage Marketplace onto its site. We have many more opportunities, especially on mobile, and together we are just getting started.

Now we turn to our second strategic priority of growing our Premier Agent business, which continues to outperform.

I have met thousands of Premier Agents at local Zillow events over the last few months and their feedback has been both inspiring and validating. Our Premier Agent business continues to gain momentum with more and more agents finding

success with us. One way we are working to help more agents is through our just-launched Zillow Tech Connect program, where leading CRM software providers can directly integrate with Zillow to help brokers and agents convert contacts they receive from Zillow into sales. Many of our successful Premier Agents leverage a CRM -- whether it's from us, or our launch partners Zurple and BoomTown, or the legacy industry providers. Our open ecosystem approach for productivity will help more of our Premier Agents be successful in the system they like, and enable them to buy more advertising from us. Our strategy is to provide our own lightweight and free agent CRM, and to remain an open system that integrates with other more sophisticated enterprise-class CRMs.

At the end of the third quarter, the annual run rate in the Premier Agent business was about \$132 million, compared to an \$80 million run-rate a year ago. September was a record month for Premier Agent revenue, and almost for net additions of new Premier Agents. We are adding Premier Agent revenue at a faster pace than at any point in our company's history.

To gauge our long-term potential in the Premier Agent business, international online real estate companies provide a template on how we might advance. Rightmove in the UK, REA in Australia, and SeLoger in France all lead in audience in their respective countries. These models indicate the possibilities for pricing, revenue and margin structure for the leading company in a market over the long term. Today we believe we connect consumers and agents in perhaps 2 percent of homes' for-sale transactions. Because of the industry structure in the U.S., the path to realize the potential to lead the domestic market runs through audience leadership. Advertisers follow audience.

Over the long term, we anticipate the total addressable market for ad revenue from agents to evolve as the category winner extends its lead. While we believe agents today spend 10 to 20 percent of their \$60 billion in commissions on advertising, we believe ad dollars will shift to more of a revenue generation practice, similar to search engine marketing where some advertisers spend nearly up to their marginal revenue. In other words, we think that agents will view

online impression-based advertising in the same way they have traditionally viewed lead referral economics, which is to say they are willing to pay up to 40 percent of their commission to the channel that provides them with a customer. Hence, it is possible that the total online advertising pie in our category could grow from its current \$10 billion range to something 2-3 times larger, and this is consistent with international comps.

We are hearing stories from Premier Agents across the country that validate this – they start small and keep buying more impressions from us, and hire more agents to work for them. They keep spending money on the margin because they are making money on the margin, and the TAM (total addressable market) expands.

We believe that as the breakaway leader in mobile audience, and the clear leader in desktop audience, we have a very exciting future in this one business line. There is plenty of juice left in this orange.

But we have also planted other seeds that are starting to bear fruit.

So, turning now to our emerging marketplaces..

First in our mortgage marketplace, we received another record level of loan requests in the third quarter -- almost 6 million, and mortgage revenue grew over 100 percent year over year for the fourth quarter in a row. Still, consumer awareness and usage of Zillow Mortgage Marketplace represents a tremendous opportunity for us. This quarter we increased our PR and marketing efforts for Zillow Mortgage Marketplace, with a primetime feature on ABC World News with Diane Sawyer, and early last month we hosted a Google+ Hangout with the Federal Housing Finance Agency on the Home Affordable Refinance Program. Zillow Mortgage Marketplace also had favorable coverage this quarter in The New York Times, The Wall Street Journal, Bloomberg, Forbes and The Washington Post.

Additionally, we recently revamped our mobile Web experience for mortgages, which is showing terrific usage stats similar to our standalone apps. And during

the quarter we opened the new Lincoln, Nebraska office for the Mortech business, which was attended by local government and press. All in all, great strides are being taken with our mortgage marketplace.

In the Zillow Rentals marketplace, we are gaining traction in our initial monetization efforts via paid inclusion, which we started just a few months ago. Our value proposition to property managers competes extremely well on price and value versus competitors. When considering that we deliver more than twice as many rental contacts as for-sale contacts (albeit it with a lower potential value per lead), our rentals business is a “gusher” that has not had a pipeline setup for it yet. For perspective, our mortgage business took three years once we began iterating on monetization to reach \$10 million in annual revenue. Rentals can ramp faster because 1) the Zillow/StreetEasy/HotPads brands are widely known among rentals advertisers, 2) our experience with Premier Agent has educated us on how to build out this business, and 3) we already have the renter audience.

In our nascent home improvement marketplace, Zillow Digs, we continue to make progress in usage and engagement. Last month, we launched our first-ever Zillow Digs App for iPhone, which was heavily featured in Apple’s App Store at launch.

Before concluding my remarks today, I wanted to take a moment to highlight the efforts of our housing research team led by our Chief Economist Stan Humphries. Zillow’s housing research team just hosted a fourth successful housing forum in Washington, D.C., focused on solving the lingering issues of the housing recession. The event included keynotes by Carol Galante, the Federal Housing Administration commissioner and assistant secretary for housing, and Edward J. DeMarco, acting director of the Federal Housing Finance Agency (the regulator for Fannie Mae and Freddie Mac). Other speakers included Senator Mark Warner (D-Va.) who is the co-sponsor of the leading Senate bill on mortgage finance reform, and Congressman Randy Neugebauer (R-Texas) who is a co-sponsor of the leading House bill on mortgage finance reform. Richard Smith, CEO of Realty, was also a featured speaker, in addition to speakers from CNBC, The Wall Street Journal and The Washington Post. The forum generated extensive media coverage when

DeMarco of the FHFA announced a highly-anticipated decision to maintain higher conforming loan limits for another several quarters.

Events like these highlight Zillow's data and our unbiased, objective voice for the consumer in Washington, as well as our real estate and mortgage industry leadership.

In conclusion, Zillow's growing separation in usage on mobile and Web against the other category participants clearly indicates we are executing our strategy effectively. Whoever wins with consumers will likely end up taking most of the revenue and profits in the category.

With that I will turn the call over to Chad.

Chad Cohen, CFO:

Thanks, Spencer.

As Spencer mentioned, this was an extremely strong quarter, with traffic growing 69 percent year over year to 61.1 million average monthly unique users, cresting in August with approximately 64 million. To put this in perspective, at our seasonal peak in August, we added 27 million monthly unique users from the same period in 2012. You should note that it took us nearly 6 years to attract our first 27 million monthly unique users.

Turning to our financial performance, third quarter revenue totaled a record \$53.3 million, up 67 percent year over year. Compared to our outlook, we exceeded the \$50 million midpoint of our range by \$3.3 million primarily due to outperformance in our Display revenue category, and a very small contribution from StreetEasy, as the results of their operations were only included in 1 month of the quarter.

Marketplace revenue reached \$41 million, representing 73 percent year over year growth and 77 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, Rentals and now StreetEasy product lines, revenue was \$35.1 million in the quarter and grew 67 percent year-over-year. The primary driver of growth was our Premier Agent business, where we added a record 5,942 Premier Agents in the quarter, with a net increase of 18,046 Premier Agents from this time last year.

Average monthly revenue per user, or ARPU, was \$264 in the quarter for the Premier Agent business, and represented a 2 percent decrease from last year and 1 percent decrease sequentially from the previous quarter. The decrease in ARPU is a function of timing of new agent additions as well as more agents becoming Platinum subscribers at initial impression levels that are lower than average.

Upsells to existing agents who purchased additional impressions represent about 50 percent of our new bookings during the quarter, and naturally counterbalance against new subscribers who initially come on board at lower levels of spending. This dynamic reflects agents over time proving out the ROI for themselves and wanting to increase their marketing activity with us. These trends have been consistent since launching impression-based pricing last year. As a reminder, the ARPU figure is an output that is neither a proxy for pricing nor a metric we use to run the business. Our inventory model allows agents to purchase available impressions at prices that are determined by local market conditions.

Turning from real estate to our mortgage business, which consists of our Zillow Mortgage Marketplace and our Mortech software business, revenue reached \$5.7 million and grew 120 percent year over year. During the third quarter, 5.9 million loan requests were submitted to Zillow Mortgage Marketplace, growing 88 percent over last year. In one quarter, we now receive more loan requests than we did in the entire year of 2011. The vast majority of loan requests submitted continue to be for purchase loans as opposed to refinancing.

Looking now at our Display category, revenues were \$12.4 million and increased 50 percent year over year, which is the fourth consecutive quarter of accelerated growth. We experienced significant growth across most of our primary Display verticals including builders, banking and brokerages. Our Display business represented 23 percent of total revenues this quarter and continued to deliver a strong contribution margin.

Moving now from revenue to our expenses, total operating expenses were \$58.8 million in the third quarter as compared to \$29.6 million in the same quarter last year. The \$29.2 million increase in expenses versus last year was primarily due to two factors: 1) increased headcount-related expenses reflecting growth from nearly 500 employees to more than 780 employees, with approximately 70 of the 280 new employees coming via acquisitions; and 2) increased advertising investments to grow our audience. Our OpEx increase year over year would have

been closer to 65 percent, or \$19.1 million, if we were to exclude the investments we're making to grow audience.

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

In the third quarter, our cost of revenue was \$5.1 million or 10 percent of revenue, as compared to \$3.6 million or 11 percent of revenue in the same period last year. Higher levels of engagement with Zillow-owned and -operated properties versus our revenue-sharing partners drove cost leverage. Absolute dollars grew as a function of higher revenue levels and data center costs to support both product investments and audience growth across our platform.

Next, sales and marketing expenses, which include our Premier Agent sales team, marketing team and advertising activity, were \$31.2 million or 59 percent of revenue, as compared to \$14.1 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 \$10.1 million. Excluding the investment increase, sales and marketing expenses increased approximately 50 percent year over year, and represented 40 percent of revenues.

Technology and development costs were \$12.2 million or 23 percent of revenue, compared to \$6.7 million, or 21 percent of revenue last year. Consistent with prior quarters, the increase in expenses was primarily driven by the growth of our engineering teams (organically and through acquisition) to support product initiatives and higher amortization of intangibles year over year related to acquisitions. On an absolute basis and as a percent of our revenue we continue to invest more in technology than any other public real estate media company, which helps us extend both our audience lead and increase our overall value to our real estate advertisers.

Lastly, G&A costs were \$10.4 million or 19 percent of revenue, as compared to the same period in the prior year at \$5.2 million or 16 percent of revenue. This increase was driven by higher headcount-related costs combined with increased professional services and facilities costs to support our growth.

Turning now to profitability, our EBITDA for the quarter was \$4.1 million representing 8 percent of revenue. This result exceeds our guidance midpoint by \$2.4 million, primarily due to the higher revenue than we projected flowing through to the bottom line.

On a GAAP basis, net loss for the quarter was \$1.2 million, representing a GAAP loss per share of 3 cents for basic and fully diluted shares of 36.7 million. We recognized a one-time tax benefit of \$4.3 million in relation to the acquisition of StreetEasy.

On a non-GAAP basis, which excludes share-based compensation and the one-time tax benefit, the adjusted loss per share was 5 cents for basic and fully diluted shares.

Post our capital raise, we ended the quarter with approximately \$425 million in cash, cash equivalents and investments. We remain debt-free.

Now I'll discuss our outlook for the rest of 2013.

As we close out the year, we expect to see continued strong momentum in our marketplace businesses, and a sequential decrease in display revenues, which follow typical seasonal patterns that impact our traffic results.

For the fourth quarter, our revenue is expected to be in the range of \$55 to \$56 million, which represents 62 percent year-over-year growth at the midpoint of the range.

Looking at the Sales and Marketing line item in the fourth quarter, we anticipate recording total expenses of \$25.5 to \$26.0 million for the period, a planned decrease from the third quarter as we pull back our media spending in the seasonally slower home shopping period.

Our EBITDA for the fourth quarter is expected to be approximately \$8.5 to \$9.0 million. Looking at the projected reconciling figures to EBITDA, total share-based compensation in the fourth quarter is expected to be in the range of \$4.5 to \$5.0 million, and depreciation and amortization expenses are expected to be in the range of \$6.5 to \$7 million. Although we do not provide a GAAP EPS outlook, we expect a basic and fully diluted weighted average share count of approximately 40 million shares for the quarter.

Now looking at full year 2013, we are raising our revenue guidance from the previous range of \$186 to \$188 million to a range of \$194 to \$195 million for the year, representing 67 percent year-over-year growth at the midpoint of the range. To give some perspective on our momentum through the year, when we started 2013, we projected revenue between \$165 and \$170 million for the year. We are closing out strong, with a projected annual revenue growth rate that is 23 percentage points higher than what we anticipated at the start of the year.

Regarding full-year Sales and Marketing expenses, we now project nearly \$110 million in total expenses for the year in the income statement. This figure includes approximately \$3 to \$4 million of share-based compensation and the one-time \$7 million accelerated share-based charge we recorded earlier in the year.

Due to revenue out-performance in the third quarter, we now expect approximately \$23 million in full-year EBITDA, which is \$3 million above our previous outlook. Looking at the reconciling figures, we anticipate total depreciation and amortization expenses for the year to be in the range of \$22.5 to \$23 million and share-based compensation to be in the range of \$22 to \$23 million. Total CapEx and capitalized data content we expect to be in the range of \$12 to \$13 million for the year. We project full year 2013 basic and diluted share

counts to be 35.5 and 39.0 million weighted-average shares, respectively, though we are not predicting positive net income for the year, so only basic shares would apply.

In conclusion, we continue to gain traction against our long-term objective of becoming an enduring household brand. We achieved record results in traffic and revenues in the third quarter. We continue to separate ourselves from our competitors in terms of audience. We remain focused on our priorities of growing our audience, growing our Premier Agent business and growing our emerging Marketplaces on mobile and on the Web, and we remain tremendously excited about executing against our massive market opportunities in the lifecycle of homes.

Thanks for your time today. With that, we'll open up the call for questions and remind you that we will be considering questions submitted via Twitter and Facebook with the hashtag #ZEarnings.

Spencer Rascoff, CEO after Q&A:

Thank you very much for joining us today. We continue to be excited about the tremendous opportunities ahead for us as we separate from the category. After concluding here, I will answer a few more questions with the #ZEarnings hashtag on Twitter from both investors and analysts at the Motley Fool.

¹ comScore Media Metrix, September 2013