

## **ZILLOW, INC. Q4 2013 EARNINGS – PREPARED REMARKS**

Feb. 12th, 2014

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

Thank you. Good afternoon and welcome to Zillow's fourth quarter and full year 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 Zillow's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 and in our other filings with the SEC.

In addition, please note that the date of this conference call is Feb. 12, 2014, 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 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, TheStreet will moderate a brief follow up Q&A session with Spencer via Twitter with the same #ZEarnings hashtag. I will now turn the call over to Spencer.

**Spencer Rascoff, CEO:**

Thank you for joining us today to review Q4 and 2013.

We finished 2013 in fantastic form, hitting new highs for quarterly and annual revenue and achieving strong quarterly profitability. Zillow traffic continued to grow, accelerating our leadership position and category share. According to comScore, we are now nearly twice the size of our two closest competitors on combined mobile and Web traffic<sup>i</sup>. And, we're growing faster – on desktop, comScore shows Zillow tripling our category lead in 2013<sup>ii</sup>.

We have always said that Advertisers follow Audience, and our revenue results in the fourth quarter prove it. Excellent execution by our Marketplace and Display sales teams resulted in Q4 revenue of more than \$58 million, up 70% year-over-year. Fourth quarter EBITDA was more than \$15 million, 26% of revenue and higher than we planned. Notably, our Premier Agent business reached an annual run rate of more than \$150 million, compared to a \$90 million run-rate at this time last year. We ended 2013 with a Premier Agent count of more than 48,000 agents as we added close to 19,000 net agents over the year.

The strong finish in the fourth quarter took our 2013 full-year revenue to \$197.5 million, growing 69% over full-year 2012. EBITDA for 2013 was almost \$30 million, and represented 15% of revenue.

Drilling down now on traffic, we widened our audience lead substantially this year – as a media model we believe that Audience leadership determines the long-term winner.

According to comScore, in December 42% of all mobile and Web visitors to online real estate services went to Zillow, which is twice the share of the No. 2 and No. 3 brands, respectively<sup>iii</sup>.

According to self-reporting of traffic from Google Analytics, we finished the seasonally slow fourth quarter with more than 54 million average monthly unique users. In January 2014, traffic accelerated substantially to nearly 70 million unique users, an addition of 24 million UUs year-over-year.

Our results in traffic and our record performance in annual revenue and EBITDA demonstrate our continued category leadership and sustained business momentum. Without a doubt, 2013 was a breakaway year for Zillow.

As we turn our focus now to 2014, our strategic priorities remain consistent, and they are: 1) grow our audience and widen our category lead, 2) grow our Premier Agent business, and 3) grow our advancing marketplaces.

Our first priority of growing our audience begins with our immersive products that empower consumers when they buy, sell, own, rent, finance and remodel homes. We are able to build products across this broad spectrum because of our living database of all homes, which continues to be a distinct competitive advantage, and an asset which we continue to invest in.

Specifically on mobile, we continue to invest significant product resources in evolving our mobile Web experience, and launching and improving our apps. We now have 27 mobile apps across every major platform. This broad and long-standing product investment in mobile has resulted in a growing category lead – Experian pegs our mobile Web audience at four times the size of the No. 3 player, and two and a half times the size of the No. 2. We are deeply capturing the consumer shift to mobile, as we now see approximately two-thirds of Zillow visits coming from a mobile device.

Other notable product advancements during the quarter included the launch of a Zillow Real Estate App on Windows 8 for desktop, laptop and tablet, with features specifically designed to take advantage of the Windows environment. Also, we just launched a new unique content offering - our cost of home ownership feature - where consumers looking at homes can see estimated monthly expenses, such as cable and home security, in addition to estimated mortgage payments and property taxes. Creating new products and features, adding richer content and providing deeper market context increasingly resonates with more and more consumers.

And adding to our reach, we recently expanded our distribution network to include AOL Real Estate, which joins our existing partners Yahoo! Homes and HGTV's FrontDoor.com. Zillow is now the exclusive provider of for-sale and for-rent listings to four of the top real estate websites in the country.

While product is the core driver of Zillow's growth, we will be increasing our investment in national advertising this year to accelerate that growth. I will get into more details of our 2014 plans in a moment, but first I want to touch on the 2013 results that give us the confidence to invest even more.

In May 2013, we launched our first-ever national TV campaign, after two rounds of testing showed promise. After just six months of television advertising, we were extremely encouraged by the strong signal and results. At the top of the funnel, 2013 total traffic grew nearly 60% year over year. In turn, home shopper traffic grew 80%, and contacts to agents grew over 70%. This tells us that not only was our advertising successful in growing traffic, but it grew the intended traffic of transaction-ready buyers.

We also see the impact of our television advertising in increased brand awareness. You can see this nicely in Google Trends (viewable at [trends.google.com](http://trends.google.com)) – which measures branded search query share – and shows in January that searches for the term “Zillow” increased more than 40 percent over

last January. Meanwhile the real estate category was down and our closest competitor was essentially flat<sup>iv</sup>. The Zillow brand is breaking away from the category in a meaningful way.

Building on our success in 2013, this year we will go farther than before and take advantage of what we have learned. In 2013, we spent nearly \$40 million in advertising across all channels. In 2014 we plan to increase our advertising investment to \$65 million across all channels. After intentionally advertising lightly on TV in the seasonally-slow fourth quarter, we are back on-air as of a few weeks ago, and we will be launching new creative in the coming months. You can view our current TV spot at [Zillow.com/TV](http://Zillow.com/TV). The bulk of our investment will take place leading up to, and during the peak home shopping months, and like 2013 we will lighten our spending during the fourth-quarter off-season.

In our quest to become a household name, the time is right for us now to press our advantage and further elevate our brand, and extend our category lead. As we have discussed before, in both international real estate models and comparable categories like search, the path to category leadership over the long term runs through audience. While we will forego some profitability in the near term to grow our audience market share, the long game is about capturing revenue share and expanding profit margins – first, we win audience, then we reap most of the revenue and the profits. We are in growth mode, early on in the midst of executing a multi-year brand building effort to secure strategic competitive advantage, and we couldn't be more excited about the massive opportunities in front of us.

Turning now to our second strategic priority of growing our Premier Agent business, we continue to fire on all cylinders, with record revenue, agent count and ARPU. We are signing up more agents across the country who want to partner with us to grow their business. Historically, we have priced our Premier Agent subscriptions to drive adoption, with the average contract delivering an estimated 10x ROI for agents. Premier Agents who have been with us more than a year spend well above their initial contracted amount, and significantly above overall ARPU. Our platform attracts many of the best agents in every market, which ultimately leads to a superior consumer experience and makes Zillow more valuable to consumers and agents alike. One way this value manifests itself is through agent reviews by consumers – we now have nearly half a million reviews of agents on Zillow, which assist consumers in finding the right local agent for them.

To help our Premier Agents convert more of their contacts into sales, we provide agents with connectivity to CRM tools of their choice – something that no competitor in our category is capable of doing. We recently added nine more CRM providers to the Zillow Tech Connect program, including, Wise Agent, Commissions Inc., planetRE and ZipRealty. Zillow Tech Connect now includes 11 different CRM providers. An agent using a system to process leads will be more successful than one who doesn't. Zillow Tech Connect offers a unique and rapidly expanding open ecosystem for technology in

the real estate industry. We seek to support the various technology platforms that many real estate brokers and agents invest heavily in to accelerate their businesses. By allowing agents to work with the CRM system they prefer, Zillow is able to partner with and sell more advertising to an increasingly attractive segment of agents. In addition to connecting to a dozen other CRMs, we provide our own FREE and lightweight software suite to agents, giving all Premier Agents access to a technology solution to convert leads into deals.

Now I'll turn to our third strategic priority of growing our advancing marketplaces, starting with mortgages. We crossed a milestone recently, surpassing 60,000 consumer reviews of lenders on Zillow. Another notable mile marker was the launch of an important new product: Pre-approval. Now, consumers who want to verify how much they can afford and who want to demonstrate to agents and sellers that they're credible buyers, can get pre-approved by a lender on Zillow in just minutes. Through a safe and secure process, consumers can find a top-rated lender to pre-approve them and issue a printable and shareable pre-approval letter on the spot. We have received terrific consumer feedback on this product so far.

In our rentals marketplace, we continue to experience strong growth. As our highly-engaged renter audience – the largest in the rental media category – continues to grow, our value to our rental advertisers only increases. We have been hard at work enhancing our rental offering, which features the largest, most diverse inventory of real rental listings available anywhere, and we have product investments queued up to deploy over the course of the year. Our most recent product release was the re-launch of Postlets, a listing syndication tool that eases the pains of marketing rental properties for smaller landlords and property managers. Postlets is now mobile-optimized, and we've just shipped Postlets mobile apps on iPad and iPhone; this enables landlords, property managers, owners and real estate agents to create, publish and manage their listings from anywhere. We have also created meaningful merchandising opportunities for large apartment buildings, increasing the share of contacts that we drive to these properties. We also recently raised our monthly price per building to \$120 per building, which is still a significant discount to competitors' pricing. At this time we remain very early in the development of the destination marketplace for rentals, and look forward to building on the foundation laid thus far in 2014 and beyond.

Taking a closer look now at our New York City marketplace, I am very excited about our New York property StreetEasy. Today, we announced a relaunch of StreetEasy, which includes two key elements. First, we are now providing consumers with free access to all of StreetEasy's local data and New York-tailored shopping tools that were previously only available for paying users. Making valuable real estate data available to consumers for free aligns with the Zillow ethos of information transparency and empowering consumers. Second, we also unveiled a brand-new site design. This year we are investing meaningful resources to enhance our product user experience and expand our footprint

within the largest and most important real estate market in the country. Further, StreetEasy is also prioritizing efforts on mobile development, both improving our existing app experience and adding new platforms. The focus in 2014 for StreetEasy will be on expanding and improving the product, especially on mobile, to address the substantial opportunity in New York.

Taking it all in, 2013 was fantastic by all measures. We executed very well against our strategic priorities, and 2014 has started off strong already, with record traffic last month.

For 2014, we expect revenue of \$288 million - \$294 million, and EBITDA of approximately \$38 million - \$40 million. We are pushing ourselves harder than ever to take more market share of the category profitably, with our eyes on the long-term opportunity to win the category outright.

Before I conclude, I would like to take a moment to acknowledge the groundbreaking efforts of our economic research team led by our Chief Economist Dr. Stan Humphries. We recently hosted a live town hall in our Seattle office with Secretary of Housing and Urban Development Shaun Donovan on the topic of equality in housing. In addition to attendance by local and national press, and live streaming on Zillow, representatives of the National Urban League were present to discuss the recent report from Zillow that highlighted data on minority access to housing. The event inspired important conversation nationally, and allowed Zillow to amplify the voice of the consumer with government and industry.

In conclusion, 2013 was a breakaway year for Zillow. The market opportunities in front of us remain large and virtually untapped which inspires us to move fast. As we look forward to 2014 we will continue to press our advantage and focus on executing against our strategic priorities of growing our audience, growing our Premier Agent business, and growing our advancing marketplaces.

Now I will hand the call over to Chad.

**Chad Cohen, CFO:**

Thanks Spencer.

I'll start off with our fantastic traffic growth in the fourth quarter and then move into operating results. We attracted 54.3 million average monthly unique users to visit Zillow's mobile applications and websites in the fourth quarter, growing 57% year over year – a 10 percentage point acceleration over last year's 47% growth rate – on a much larger user base – and with seasonally light advertising support.

Now to our operating results, total revenue for the 4th quarter increased 70% year-over-year to a record \$58.3 million from \$34.3 million in the same quarter last year. This growth represented a re-acceleration over the prior quarter. Total revenue in the fourth quarter exceeded the midpoint of our guidance of \$55.5 million by approximately \$2.8 million or 5%. We continue to see a favorable shift in our revenue mix as we ended the fourth quarter with 79% of our revenue coming from our Marketplace category, while 21% came from Display.

Taking a deeper dive into our primary revenue category, Marketplace Revenue grew 71% year-over-year to \$45.9 million. We continued to see strong growth across our Real Estate and Mortgage subcategories.

Going further into our Real Estate subcategory, which accounts for our Premier Agent, Diverse Solutions, StreetEasy and Rentals businesses, our revenue accelerated sequentially and grew 71% year over year to reach \$40.5 million compared to \$23.7 million last year. Our Premier Agent business continues to execute nicely, and during the quarter we added 3,565 net new Premier Agents, ending the period with 48,314 subscribers. The vast majority of additions were at the platinum level, continuing the trend we've seen throughout the year. 55% of our new sales bookings in the fourth quarter went to existing agents buying more impressions across mobile and Web, which is higher than recent trends and signifies strong underlying demand.

Average monthly revenue per subscriber, or ARPU, among Premier Agent subscribers was \$271 in the fourth quarter, which was 1% higher than the figure in the same period last year, and 3% higher sequentially compared to our third quarter. As a reminder, ARPU reflects what an average contract size looks like, which is a function of the amount of impressions an agent buys and the current prices they are paying per impression; it does not indicate just the price that an agent pays for a subscription in a market. Pricing of our Platinum Premier Agent subscriptions varies by geographic market due to local home values, contact liquidity and demand for impressions in a ZIP code.

Moving from real estate to mortgages, which consists of Zillow Mortgage Marketplace and Mortech, revenue reached \$5.3 million and grew 69 percent year over year and benefits from a full quarter contribution of Mortech revenue, compared to a partial period in the fourth quarter last year. Mortech contributed \$1.5 million in the fourth quarter this year. In Zillow Mortgage Marketplace, 4.4 million loan requests were submitted, growing 39% year over year. Home purchase requests continued to remain the prevailing inquiry by consumers.

Looking at our Display category, revenue in the fourth quarter grew 67% year over year to \$12.5 million. This represented the fifth consecutive quarter of accelerated growth, and reflects highly on the efforts of our display sales team, the strength of our model and the value we provide to advertisers, especially home builders, banks and real estate brokerages.

Shifting now from revenue to our operating costs, total operating expenses were \$55.6 million compared to \$33.8 million during the fourth quarter 2012, improving by 3% of revenue versus last year.

Working down the expense line items, comparing the fourth quarter results this year to last year:

First, our cost of revenue during the quarter was \$5.3 million, or 9% of revenue, compared to \$3.8 million, or 11% of revenue last year. Favorable leverage resulted from our revenue sharing arrangements due to higher growth from our owned and operated properties compared to our partners.

Next, Sales and Marketing expense was \$25.0 million, or 43% of revenue, versus \$14.5 million last year, at the same percentage of revenue. Total advertising spend in the 4th quarter was approximately \$8 million, which was \$4.5 million more than in the fourth quarter of 2012, and devoted primarily to online channels.

Technology and Development costs in the quarter were \$14.6 million, or 25% of revenue, compared to \$9.1 million, or 27% of revenue, in the fourth quarter 2012. The increase reflects higher depreciation and amortization costs and increased headcount-related expenses year over year, but at lower than planned levels.

G&A costs in the fourth quarter were \$10.7 million, or 19% of revenue, as compared to fourth quarter 2012 of \$6.4 million, at the same percent of revenue. The primary increase in absolute dollars year over year is attributed to higher headcount and services costs, as well as higher facilities costs to support our growth.



EBITDA for the quarter was \$15.2 million, representing 26% of revenue, which was up from \$6.8 million, or 20% of revenue in the fourth quarter 2012. Along with our revenue upside flowing through to earnings, we had positive variances versus our plans throughout our cost structure related to headcount, as well as capitalized website development expenses, and facilities improvements.

GAAP net income was \$2.7 million in the fourth quarter, compared to \$0.5 million in the fourth quarter 2012. Fourth quarter 2013 basic and diluted earnings per share were \$0.07 and \$0.06, respectively, based on 39 million and 42 million weighted average shares outstanding. On a Non-GAAP basis, which excludes share based compensation and non-recurring income tax items, basic and diluted earnings per share were \$0.20 and \$0.19, respectively.

Moving now to our full-year 2013 performance, total revenue increased 69% to \$197.5 million, up from \$116.9 million generated in 2012. Compared to our original outlook of \$165 to \$170 million, our business accelerated ahead based on strong underlying fundamentals, along with a small contribution from our acquisition of StreetEasy. In our revenue categories, Marketplace revenue increased 78% year over year to \$154.2 million, up from \$86.7 million in 2012. Display revenue for 2013 was \$43.3 million, increasing 44% from \$30.2 million in 2012, accelerating versus last year.

Our revenue mix for the year consisted of 78% of our revenue coming from our Marketplace category, while 22% came from Display – a 4 percentage point shift over 2012 results, marking the continued advancement of our Marketplace categories. Real Estate revenue grew 74% year over year to \$132.4 million, while our mortgage revenue grew 103% year over year to \$21.8 million, which includes a full year contribution by Mortech.

Looking at our Sales and Marketing expenses, we finished the year with \$108.9 million. Our advertising expense in 2013 was \$38.7 million compared to \$11.1 million in 2012, which was consistent with our plans that we laid out on the last call.

EBITDA for the full year 2013 was \$29.7 million, representing 15% of revenue, and was \$4.6M higher than 2012 full year EBITDA of \$25.2 million.

GAAP net loss for 2013 was \$12.5 million, which was \$0.35 for both basic and diluted share. On an adjusted Non-GAAP basis, which excludes share based compensation and the non-recurring income tax items, basic and diluted earnings per share were \$0.19 and \$0.17, respectively.

Turning briefly to our balance sheet, we ended the year with approximately \$438 million in cash, cash equivalents and investments, and we had no debt.

Zillow ended 2013 with more than 800 employees, up from more than 550 at the end of 2012, and we continue to grow in support of our strategic priorities: growing audience, increasing the size of our Premier Agent marketplace, and developing our other advancing marketplaces.

Now turning to our Outlook for the first quarter 2014 and the full fiscal year:

Our revenue for the first quarter of 2014 is expected to be in the range of \$62.0 million to \$63.0 million. This outlook represents 60% year over year growth at the midpoint of the range.

We anticipate sales and marketing expenses for the first quarter to be in the range of \$36 million to \$37 million.

For our first quarter outlook on EBITDA, we expect a range of \$4.0 million to \$4.5 million. At the midpoint of our range, this represents approximately a 7% margin.

Also for the quarter we expect depreciation and amortization in the range of \$8 million to \$9 million, and share-based compensation in the range of \$6 million to \$7 million.

Although we are not providing a GAAP EPS outlook for the first quarter, we expect a basic and diluted weighted average share count of approximately 40 and 43 million shares, respectively.

Recapping our 2014 guidance, we anticipate full-year revenue of approximately \$288 million to \$294 million, and we project approximately \$38 million - \$40 million in EBITDA. As Spencer mentioned, we plan to invest approximately \$65 million in advertising across multiple channels this year, as well as increase our investments in product development as we pursue our strategic priorities.

For the full year 2014 we anticipate Sales and Marketing expenses will reach approximately \$158 million to \$160 million.

Moving quickly to reconciling items to EBITDA for the year, we expect depreciation and amortization to be in the range of \$38 million to \$41 million, share-based compensation in the range of \$28 million to \$30 million, and CapEx and capitalized purchased data content in the range of \$17 million to \$19 million. We expect full year 2014 basic and diluted share counts to be approximately 41.5 million and 45.5 million weighted average shares outstanding, respectively.

To conclude, Zillow had a fantastic fourth quarter and a spectacular 2013. We remain determined to accelerate our growth and advance our home-related marketplaces, and we are extremely excited about our potential in 2014 and beyond.

With that we'll open it up for questions from those dialed into the call, and to questions submitted via Twitter and Facebook with the hashtag #ZEarnings.

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<sup>i</sup> comScore Media Metrix (Multi Platform), December 2013

<sup>ii</sup> comScore Media Metrix (PC only), January through December 2013

<sup>iii</sup> comScore Media Metrix (Multi Platform), December 2013

<sup>iv</sup> Google Trends, January 2014