ZILLOW GROUP, INC. Q4 2015 EARNINGS – PREPARED REMARKS
February 11, 2016

RJ Jones, VP of Investor Relations:

Thank you. Good afternoon and welcome to Zillow Group's fourth quarter and full year 2015 earnings conference call. Joining me today to talk about our results are Spencer Rascoff, Chief Executive Officer, and Kathleen Philips, Chief Financial Officer.

During the call we will make forward-looking statements regarding future financial performance and events. Although we believe the expectations reflected in the forward-looking statements are reasonable, we can't guarantee these results. We caution you to consider the risk factors in our SEC filings, which could cause actual results to differ materially from those in the forward-looking statements made in the press release and on this call.

The date of this call is February 11th, 2016, and forward-looking statements made today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of new information or future events.

During this call, we will discuss GAAP and non-GAAP measures. We will also discuss results on both a reported and pro forma basis. Reported results were prepared in accordance with GAAP unless otherwise noted. For comparative purposes, pro forma results assume the February 2015 acquisition of Trulia occurred on January 1, 2014, and reflect certain adjustments and exclusions described in our SEC filings. All year-over-year comparisons are pro forma unless otherwise noted or the context otherwise requires. We encourage you to read our press release, as it contains important information about our reported and pro forma results, including reconciliation of non-GAAP financial measures.

In our remarks, the non-GAAP financial measure Adjusted EBITDA is referred to as EBITDA, which excludes other income, depreciation and amortization expense, share-based compensation expense, acquisition-related costs, restructuring costs, loss on divestiture of business, interest expense, and income taxes.

This call is being broadcast on the Internet and is available on the Investor Relations section of the Zillow Group website. A recording will be available after 8:00 p.m. Eastern time today. Please note that the earnings press release is available on our website and, after the call, a copy of today's remarks will also be available on our website.

Today we will open the call with prepared remarks. We will follow the prepared remarks with our standard live question-and-answer session. During the Q&A, we will answer questions asked via Twitter and take questions from those dialed into the call. Individuals may submit questions by tweeting @ZillowGroup using the #ZEarnings. I will now turn the call over to Spencer.

Spencer Rascoff, CEO

Thank you and welcome everyone to our fourth quarter and full year 2015 earnings call. I will discuss 2015 business highlights and our strategic priorities, then Kathleen will go into the details of our financial results. We will then open the call up to questions.

Before I get started on Zillow Group specific results, I wanted to take a moment and give our general view of housing and the economy. Zillow Group's economists generally like what we see in the data. American household budgets and balance sheets are stronger now than in 2008, and the American consumer so far hasn't been impacted by declining stock prices. Despite global issues stemming from China and commodities, we just aren't seeing them negatively affect most American households. It's possible that these global issues will affect American consumers at some point, especially if companies slow hiring, but for now the global economic issues seem confined more to Wall Street, which is seeing incredibly volatile capital markets, than to Main Street, which is benefiting from low gas prices and seeing solid employment, decent wage growth, and relatively affordable for-sale housing.

On a historical note, we had the pleasure of celebrating the 10-year anniversary of the Zillow brand yesterday. As I looked around the packed room, I was proud of the longevity of our leadership team, almost all of whom who have been here since launch 10 years ago. It was also an opportunity to reflect on the decade it took to build this incredible company, and the reasons for our success now and into the future. At its core, it's all about our incredibly talented employees – old and new. Across Zillow Group, our talent is the best in class – from performance marketing, to product development, to sales, to mobile leadership – and they bring together diverse viewpoints to create the best experiences for consumers and professionals. This has resulted in the best-known, most-used real estate media brands, and the widest competitive moat in our category.

OK, now turning to Zillow Group Results…

2015 was a transformational year for Zillow Group. We formed the largest real estate media company in the world though the combination of Zillow and Trulia. We established the foundation for our long term growth and category leadership, which is comprised of: our leading audience market share on mobile and Web; our multi-brand portfolio of leading consumer websites and mobile apps; our integrated advertising platform for our real estate, mortgage and rentals offerings; the expansion of our software tools for real estate professionals; our strong industry partnerships with nearly every major real estate franchisor, brokerage, apartment management company, mortgage lender, and multiple listing service; and our extraordinary employees, who are the most innovative, mission-oriented and technologically sophisticated group in our industry.

2015 was very exciting strategically. We acquired two large companies that expanded our capabilities and reach, we accomplished major feats of integration quickly, and we launched new products across several of our marketplaces that were very well received. We are now in position to do more than we could before as separate companies by benefiting from our scale of audience and listings, unified customer focus, and combined talents that create competitive advantage.

Looking briefly at 2015 results on a pro forma basis, we finished the year strongly and in-line with our outlook. Revenue for the year was approximately $680M up 18% year over year or 24% year-over-year without Market Leader, which we divested in Q3. In the four years since our IPO we have grown revenue more than 10X from $66M to $680M. EBITDA in 2015 was more than $95M, or 14% of revenue, and grew 34% year over year.

With the Trulia acquisition and integration successfully behind us, we are excited to turn the page to 2016.

For 2016 we are focused on four strategic priorities. First, grow our audience. Second, grow our agent advertising business. Third, grow our emerging marketplaces. Fourth, continue to maintain our extraordinary company culture which attracts, retains and motivates incredible people to do their best work.

Our first priority is to grow audience size and client contacts to real estate professionals. As you have heard me say many times, advertisers follow audience. In the fourth quarter our traffic reached nearly 124 million average monthly unique users, with an annual seasonal peak of 150 million in July last year. Our strength in mobile usage and mobile monetization continues, comprising approximately two-thirds of our usage. As we exited 2015, our audience market share was nearly 60% of the category according to comScore, which is more than twice the nearest competitor.

On our Trulia brand, we are now seeing positive traction in terms of traffic growth, as December figures from comScore showed Trulia return to its spot as the 2nd most visited real estate site, a position it had slipped from for much of 2015. According to our internal traffic data for January, Trulia hit all-time highs in organic UUs, total visits, and most importantly in leads to real estate agents. We are encouraged by internal and external measures that indicate our efforts to improve fundamentals are paying off. Looking down the funnel, our growth in home shoppers and contacts to professionals continued to accelerate quarter-over-quarter and outpaced our audience growth.

Growing our audience starts with creating products across our brands that consumers love to use at various stages in the home life cycle. We then leverage free and paid channels to amplify awareness and to reach more consumers. In 2015 we spent over $100 million advertising our consumer brands, which was highly effective for us, according to data from services such as Google Trends and comScore. Our advertising aims to grow our awareness levels to new category highs and establish household-brand-name status. The increased investments we are choosing to make this year will help us realize long-term advantages of scale.

Our second priority is to grow our Premier Agent business.

2016 will be a pivotal year as we build upon the foundation we established in 2015. Consistent with our iterative development process we will be testing many new initiatives throughout the year. I’m excited about this, as these initiatives are designed to open up untapped opportunities and transform our business. Many of these initiatives would not have been possible if Zillow and Trulia had remained separate subscale companies, and are only made possible by our combined category leadership. Last year we were integrating. This year we are innovating.

An example is the launch of the Premier Agent App. The product is a representation of deep collaboration between the Trulia and Zillow product teams. On the heels of the completion of the integration of our ad platforms, the engineering teams in San Francisco, along with the Seattle and Irvine teams, then created the free Premier Agent app in just a few months. This innovation was only possible by combining forces and bringing together disparate technologies and talent. Key mobile productivity and communications features in the app free agents from their desks and help them convert leads into commissions at a higher rate. Through our Premier Agent app we are offering our advertisers the most holistic and modern business management platform in the industry. In addition, through our TechConnect program, the Premier Agent app connects to over 60 other CRMs that agents utilize.

Bringing this all together, our Premier Agent program helps the best agents earn more commissions. This is especially true for the highest producing agents that work with us who are capturing an increasing share in their respective markets. We are making valuable progress with these advertisers, but there is still a massive opportunity ahead.

In 2015 we estimate based on our traffic and lead volumes that Zillow Group helped our agent advertisers close around 3.9% of the residential real estate transaction sides in the U.S., which drove roughly $3.2 billion in commissions to these Premier Agent advertisers. This compares to an estimated 3.1% of transaction sides and $2.3 billion commissions in 2014. This is an important metric that we seek to grow, by increasing lead volumes to agents and brokers who convert leads effectively, and by providing them with tools and training to improve their lead conversion.

Our next priority is to grow our emerging marketplaces, which are growing even faster than our Premier Agent revenue.

Starting with mortgages, we continue to experience significant growth in loan requests, contacts and revenue. During the quarter we launched our partnership with Google Compare for mortgages, and we now power mortgage rate search results for Google. It's obviously validating that Google chose Zillow Group to power their mortgage rate search business, and it's thanks to our strategic acquisition of Mortech in 2012, which allowed us to become the innovation leader in the online mortgages advertising sector. Also in 2015, we exceeded 223,000 lender reviews, which makes us the site with the most mortgage reviews by far. Looking ahead, we continue to be well positioned to grow mortgages revenue, even in a rising rate environment, as our usage is predominantly weighed towards purchase loans.

Next, in our New York City marketplace, StreetEasy continues to be on a tear. Revenue grew 73% year-over-year in 2015, and mobile traffic was up 45%. The launch of our Neighborhood Experts product that allows agents to advertise by neighborhood has been well received. We recently announced our acquisition of Naked Apartments, the second largest rentals site in New York. This will help accelerate our growth in the NYC rental market, which represents about two-thirds of the residential living units in the city. We estimate the NYC rentals commissions market size to be about $500 million, as compared with the NYC for-sale commissions market size of $1.2 billion. We continue to be very excited about the growth and potential in our NYC marketplace as our presence continues to scale. Since we acquired StreetEasy for approximately $50 million in August 2013, their revenue has more than doubled and their mobile traffic, as measured by Google Analytics, has tripled.

Moving on to our nationwide rentals marketplace, we experienced significant growth in usage, contacts and revenue. We continue to have the leading share of traffic in the category with over 21 million average monthly unique users, twice as large as our nearest competitor, according to comScore. Our innovative ad products in the rentals space continue to gain widespread adoption in the industry.

Taking a moment now to look at our full year 2016 outlook, we are targeting revenue between $805M and $815M, and EBITDA between $115M and $125M, which represents 15% of revenue at the midpoint. This includes significant one-time legal fees, which Kathleen will expand upon in a moment.

These are still early days and we are choosing to forego near term profitability to invest in our long term growth. The opportunity in our category remains massive -- $1.6 trillion in transaction volume, leading to $80 billion in commissions, and approximately $11 billion in advertising spent by agents and home builders, which continues to shift online and to come from the highest producing agents. This does not include the additional billions of dollars of additional opportunity from mortgages, rentals, and other home-related markets.

We are at the forefront of innovation in our category. We are well positioned to lead change and take advantage of our opportunity and scale, for the benefit of consumers and professionals. We are choosing to invest in our business now and control our long term destiny. Now I'll turn the call over to Kathleen.

Kathleen Philips, CFO:

Thank you, Spencer. Before I begin, I want to outline the format of our financial results discussion. First, I will formally launch into our financial results starting with our Q4 2015 results, which are similar on both a GAAP and pro forma basis, with the exception of net loss, which includes acquisition-related costs and restructuring costs on a GAAP basis, and excludes them on a pro forma basis. Next, I will discuss full-year 2015 financial results on both a pro forma and GAAP basis. For comparative purposes, I will discuss year-over-year comparisons of our Q4 and full year 2015 financial results on a pro forma basis unless otherwise noted or the context otherwise requires. Finally, I will provide our outlook for full-year and Q1 2016 and then open the call to questions from the investment community.

As a reminder, our pro forma results assume the close of the Trulia acquisition occurred on January 1, 2014, and do not include the impact of acquisition-related costs and restructuring costs, in addition to certain other adjustments. Note that our GAAP and certain pro forma financial results, along with our pro forma comparisons, have been included in our fourth quarter and full-year 2015 financial results press release, which contains important information about how the pro formas were prepared.

Now let's dive into our financial results, starting with our fourth quarter.

Traffic growth was healthy as we finished the integration of Trulia and entered the fourth quarter, historically our seasonally slowest quarter of the year. We attracted nearly 124 million average monthly unique users to Zillow Group's mobile applications and websites during the quarter.

Turning to our operating results, total revenue for the fourth quarter increased 7% to $169.4 million. This result was at the high end of our guidance of $165 to $170 million.

Looking at our core revenue category, Marketplace Revenue grew 14% to $148.3 million, maintaining strong growth across our Real Estate and Mortgage marketplaces. We continue to see the desired shift in our revenue mix as we ended the fourth quarter with 88% of our revenue coming from our Marketplace category, as compared to 82% last year.

Taking a deeper look at our Real Estate subcategory, which accounts for our Premier Agent, Diverse Solutions, StreetEasy and Rentals marketplaces, our revenue grew 27% to reach $136.6 million. Maintaining our trend throughout this year, in Q4 we continued to encourage low performing agent advertisers to leave our program, ending the period with 92,366 Agent Advertisers. The Agent Advertisers that remain in our platform continue to buy at robust levels, as 69% of new sales bookings in the fourth quarter went to existing agents buying more impressions across mobile and Web.

Average monthly revenue per advertiser, or ARPA, among Premier Agent Advertisers grew 29% to $438 in the fourth quarter, or 9% higher sequentially quarter-over-quarter. Additionally, same agent advertiser sales were over 50% higher than last year. Our Premier Agent revenue run rate is currently $485.5 million versus $415.3 million for the same period last year.

The formation of high performing, high ARPA agent advertiser teams continues to increase at a steady pace. Agent advertisers who spend more than $5,000 per month grew 62% on a total dollar basis and 48% in advertiser count. Sequentially, this is an improvement of 5% on a total dollar basis and 3% in advertiser count, quarter-over-quarter. As we position ourselves for opportunities in the coming years, we believe that the emergence of high performing Agent Advertisers should occur even faster as the real estate market evolves.

We believe that high performing agent advertisers, or teams, will continue to earn the majority of real estate commissions. Throughout 2016, we will continue to support these advertisers by developing products that help them better serve their clients and close transactions. Enabling Agent Advertisers to increase their conversion catalyzes ARPA growth, as they will buy more advertising and grow their businesses through our program. We expect that this will happen at the expense of low ARPA, low performing agents who will either leave the program or choose to join more successful Agent Advertiser teams, further driving down total agent advertiser count throughout this year. We view this as a positive trend that creates a better experience for consumers and is expected to lower our selling costs.

Transitioning to mortgages, revenue reached $11.7 million and grew 48%. During the quarter, 8.8 million loan information requests were submitted by our users, growing 19% year-over-year on an as reported basis.

In our Display category, revenue in the fourth quarter was $21.1 million, down 25%. We view this as a continuing positive trend, and it is consistent with our strategy of de-emphasizing display in the user experience and focusing on growth in Marketplace Revenue as we shift our advertisers' display budgets towards Marketplace. Display now represents 12% of total revenue, down from 18% in the same period last year.

Shifting now from revenue and turning our attention to our operating expenses by line item, our cost of revenue during the quarter was $15.1 million, or 9% of revenue.

Sales and Marketing expense was $77.8 million, or 46% of revenue.

Technology and Development costs in the quarter were $55.8 million, or 33% of revenue.

G&A costs in the fourth quarter were $45.9 million, or 27% of revenue. This is higher by 3% as a percentage of revenue quarter-over-quarter. The increased expense was mainly due to more than $8 million in legal expenses related to the News Corp lawsuit. I will provide more detail about full-year expenses related to this lawsuit in a few moments.

Total operating expenses were $195.1 million, an increase of 16% on a pro forma basis. These increases can be attributed to investments in data acquisition, increased website and software development costs, and people, as well as increased legal fees.

Pro forma net loss was $25.1 million in the fourth quarter, compared to a pro forma net loss of $11.3 million in the fourth quarter of 2014. Pro forma fourth quarter 2015 basic and diluted net loss per share was 14 cents, based upon 178 million basic and diluted weighted-average shares outstanding.

Our fourth quarter GAAP net loss was $25.7 million. GAAP fourth quarter 2015 basic and diluted net loss per share was 14 cents. On a non-GAAP basis, which excludes share based compensation expense, acquisition-related costs, restructuring costs and income taxes, basic and diluted non-GAAP net loss per share was 1 cent.

Adjusted EBITDA for the quarter was $20.4 million, representing 12% of revenue.

Turning to our full year 2015 pro forma results, total revenue increased 18% to $679.9 million, in-line with our most recent outlook. Our growth was based on continued advances in our products throughout the integration, which helped to grow real estate revenue and revenue in our emerging marketplaces. Further, efficient advertising led to accelerated audience growth throughout the funnel during the year.

In our revenue categories, Marketplace Revenue increased 26% to $583.9 million, and display revenue was $96 million, down 15%. For the full year, display represents 14% of total revenue, down from 20% a year ago. As noted above, this reflects our continued focus on marketplace revenue and the removal of many of Trulia display ad units at the end of Q1 2015, and is in line with our strategy to prioritize the consumer experience across our Zillow Group brands.

Real Estate revenue grew 35% to $502.2 million for the year, while our mortgages revenue grew 47% to $44.7 million. Real estate revenue growth was driven by the combined scale of Zillow and Trulia in agent advertising, rentals and mortgages.

Pro forma net loss was $91.1 million for the full year, compared to a pro forma net loss of $83.3 million for full year 2014. Pro forma full year 2015 basic and diluted net loss per share was 52 cents, based upon 176.4 million basic and diluted weighted-average shares outstanding.

Adjusted EBITDA for the full year 2015 was $95.4 million, representing 14% of revenue.

Of note, legal costs related to our necessary defense of News Corps legal claims were more than $27 million in 2015 and are projected to be approximately $36 million in 2016. Absent this lawsuit, these financial resources could otherwise be used to support innovation and growth, or margin expansion.

Turning to a GAAP discussion of our full year 2015 financial results, total revenue was $644.7 million, which includes partial period first quarter contribution from Trulia as the acquisition was not closed until late February 2015.

Marketplace Revenue was $555.9 million for the full year, and our Real Estate subcategory generated $482.1 million of revenue.

Transitioning to our non-real estate revenue, mortgages revenue reached $44.3 million, Market Leader revenue was $29.5 million, and our display revenue was $88.8 million.

Moving to our operating costs, total operating expenses were $794.2 million, with the most significant increases coming from increased data acquisition costs, legal expenses and brand advertising.

Looking at our operating costs by line item, cost of revenue for the full year was $61.6 million, or 10% of revenue.

Sales and Marketing expense was $307.1 million, or 48% of revenue.

Technology and Development costs for the full year were $198.6 million, or 31% of revenue.

G&A costs for the full year were $170.4 million, or 26% of revenue.

We incurred $52.1 million in acquisition-related costs and restructuring costs resulting in a GAAP net loss of $148.9 million. GAAP full year 2015 basic and diluted net loss per share was 88 cents. On a non-GAAP basis, which excludes share based compensation, acquisition-related costs, restructuring costs and income taxes, basic non-GAAP net earnings per share was 5 cents and diluted non-GAAP net earnings per share was 7 cents.

Full year 2015 Adjusted EBITDA was $87.6 million, representing 14% of revenue.

Zillow Group ended 2015 with more than 2,200 employees, up from more than 1,100 at the end of 2014. Our current head count takes into account the acquisition of Trulia and Dotloop and the sale of Market Leader. We continue to execute in support of our strategic priorities: grow audience organically, grow our agent advertising business, grow our emerging marketplaces, and continue to maintain our extraordinary company culture.

Turning to our outlook for the full year 2016 and the first quarter of 2016.

Starting with our full year 2016 outlook, total revenue is expected to be in the range of $805 to $815 million. At the midpoint of the range, this represents 26% year-over-year growth on a pro forma basis, which excludes Market Leader revenue from full-year 2015. This is a re-acceleration of revenue growth relative to 2015. We project that Premier Agent revenue will be $590 to $595 million, representing 27% year-over-year growth at the midpoint of the range.

This is the first time we have provided a separate outlook for Premier Agent revenue. We believe this level of transparency provides better insight into growth trends in our business versus the combination of agent count and ARPA, which are outputs of Premier Agent revenue. Of note, by providing this outlook, we expect to begin phasing out our reporting of advertiser count and ARPA starting in 2017.

Display revenue is expected to be in the range of $54 to $56 million; this outlook is consistent with our strategy of de-emphasizing display in the user experience and focusing on growth in Marketplace Revenue as we shift our advertisers' display budgets towards Marketplace.

Our EBITDA for full year 2016 is expected to be in the range of $115 to $125 million, about a 15% margin at the midpoint of the range, reflecting increased expenses attributable to our investments in people, data acquisition, and brand advertising. In addition, roughly $36 million has been allocated to the defense against the News Corp lawsuit for this year. These investments and legal expenses are projected to weigh more heavily in the first half of the year, leading to EBITDA, as a percentage of revenue, to be in the mid to high single digits for the first half of the year. While our revenue growth is expected to re-accelerate, our operating expense growth is expected to decelerate throughout the year.

For the full year, we expect depreciation and amortization to be in the range of $95 to $100 million.

Additionally, we expect full year capital expenditures to be in the range of $41 to $43 million.

Our full year 2016 basic weighted-average shares outstanding is expected to be approximately 180 to 182 million and our diluted weighted-average shares outstanding is expected to be in the range of 196 to 198 million.

Shifting to our first quarter 2016 outlook, Zillow Group revenue for the first quarter of 2016 is expected to be in the range of $174 to $179 million. This outlook represents more than 8% year-over-year growth at the midpoint of the range on a pro forma basis. Excluding Market Leader, the growth rate would be expected to be over 18% year-over-year. We project that Premier Agent revenue will be $130 to $132 million, representing 22% year-over-year growth at the midpoint of the range on a pro forma basis.

Consistent with recent trends and our strategic execution, we expect Display revenue to be about $13 to $14 million for the first quarter of the year.

We anticipate total operating expenses for the first quarter to be in the range of $218 to $223 million, which at the midpoint of the range is about 13% higher than total operating expenses in the fourth quarter of 2015. This step up in expenses includes accelerated investments in our people, data acquisition and brand advertising. As well, we expect nearly $12 million in legal costs related to our defense against the News Corp lawsuit.

Our EBITDA for the first quarter is expected to be in the range of $1 to $6 million.

Our first quarter basic weighted-average shares outstanding is expected to be approximately 178 to 180 million and our diluted weighted-average shares outstanding is expected to be in the range of 194 to 196 million.

To conclude, Zillow Group had a transformative year as we completed the Trulia integration, achieved listings independence, and acquired dotloop, forming the largest real estate media company in the world. I second what Spencer has said, I am very excited about our potential in 2016 and beyond as we have built a solid foundation for future growth.

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