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RDFN.OQ - Q3 2019 Redfin Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 06, 2019 / 9:30PM GMT

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PRESENTATION

Operator

Good day, and welcome to the Redfin Corporation Third Quarter 2019 Earnings Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Elena Perron. Please go ahead, ma'am.

Elena Perron *- Redfin Corporation - Head of IR*

Thank you, Brandon. Good afternoon, and welcome to Redfin financial results conference call for the third quarter ended September 30, 2019. Joining me on the call today are Glenn Kelman, our CEO; and Chris Nielsen, our CFO. You can find the press release on our website at investors.redfin.com.

Before we start, note that some of our statements on today's call are forward looking. We believe our assumptions and expectations related to these forward-looking statements are reasonable, but our actual results may turn out to be materially different. Please read and consider the risk factors in our SEC filings together with the content of today's call. Any forward-looking statements are based on our assumptions today and we don't undertake to update these statements in light of new information or future events. During the call, the financial metrics will be presented on a GAAP basis and include stock-based compensation as well as depreciation and amortization expenses. In the event we discuss any non-GAAP measures today, we will post the most comparable GAAP measure and a reconciliation on our website. All comparisons made in the course of this call are against the same period in the prior year, unless otherwise stated.

With that, let me turn the call over to Glenn.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

Thanks Elena and hi everyone. Redfin's third-quarter revenues and net income were better than we projected in our last earnings call. Compared to the third quarter last year, revenue was up 70% to $239 million and net income was up $3.3 million to $6.8 million.

In our core business of brokering home sales, through Redfin agents and through other firms' agents working as our partners, revenues increased 22% compared to the same quarter last year. This was an acceleration from the second quarter's 17% year-over-year growth, the first quarter's 15% growth and the 13% growth in the fourth quarter of 2018.

Our share gains also continued, with 11-basis point gain from the third quarter of 2018. This is the same year-over-year gain we saw in the second quarter, and an improvement on the 10-point share gains we saw in each of the two quarters before that.

RedfinNow, our business of buying and selling homes on our own account, grew revenues from $11 million in the third quarter of 2018 to $80 million in the third quarter of 2019. Over that same time, our other businesses, primarily lending and title services, grew 92% an acceleration from the second quarter's 89% year-over-year growth, and the first quarter's 59% year-over-year growth.

Perhaps most important, third quarter gross margins improved year-over-year in all of our businesses.

Year-over-year growth in the average monthly visitors to our website in mobile applications moderated from a rate of 27% in the second quarter to 22% in the third. This was expected, as the period we're now comparing ourselves to was the second half of 2018, when a machine learning breakthrough began bringing more visitors back to our site.

But just as we passed the anniversary of that breakthrough in the third quarter, we began to see an increase in the number of visits coming to our site directly or from search engines. We're now better not just at holding on to the audience getting Redfin notifications, but at drawing in new visits from the internet. This is why we expect to keep visitor growth around 20% or higher at least through the next six months.

From 2017 until the second quarter of 2019, visits grew faster than visitors, but now in the third quarter, visits to Redfin.com grew by 19%, slower than the quarter's 22% growth in visitors. The most likely reason is that Google Analytics, the tool we used to measure traffic, has begun to over-estimate our visitor traffic. Throughout 2019, Apple's web browser has added privacy protections that have caused more of our website's returning visitors seem new to Google Analytics. This is especially true of visitors to mobile web pages that Redfin, like many companies, has recently optimized to load more quickly when accessed by a Google search.

It's as if Apple required every visitor to your home to wear a different mask each week to protect his or her privacy, and you then ask Google to count how many of those visitors are unique over the course of a month. A new mask is not always a new visitor, but Google Analytics seems to think so. The difficulty of knowing who's who may mean the whole industry shifts its focus for measuring visitors to visits. By either measure, Redfin's traffic growth is expected to be strong for at least the next two quarters.

That more people keep coming to Redfin.com on their own has reduced our dependence on mass-media ads. Compared to 2019, our ad spending in 2020 will be about the same in absolute terms, and significantly less as a percentage of revenue.

We suspect that there are diminishing returns in markets where we've advertised for years and that some of the markets getting ads for the first time in 2019 had home prices that were too low for the ads to pay off. Based on what we've learned this year, we're shifting our media spending to markets with higher home prices and reducing our spending on some types of media with a lower return on investment. This should give us better results for the same amount of money.

We also believe we'll keep benefiting in 2020 from the awareness gains that have already occurred. Even as it becomes hard to measure how many customers in any given market, in any given year, can be attributed to one ad campaign or another, what we know for sure is that ads are lifting consumers' Redfin awareness. In the markets that have gotten TV ads for five consecutive years, the percentage of people who mentioned Redfin as one of the top three real estate brokerages that come to mind has risen from 6% in 2015 to 19% in 2019. In similar markets without TV ads, the increase has only been from 2% to 4%.

We're still in the early days of building an iconic brand, trusted across the U.S. and Canada for always being on the consumer's side. We expect that the long-term benefits of this awareness increase are broad. When everyone knows our name, more people will click on our Google and Facebook ads, more Redfin.com visitors will try our service; Redfin will win more head-to-head competitions for a listing; more agents will apply to work here. This is why we believe that the awareness gains from mass-media are worth the investment.

The success of our ads depends over time on what we have to offer real estate consumers that's exciting and different. This is why Redfin has, in 2019, accelerated its investment in disruptive technologies. In the third quarter, we expanded Redfin Direct Access from a San Diego pilot to all of Southern California, and Austin, Dallas and Denver. Direct Access lets home buyers unlock Redfin listings using their phones, touring the home without an agent.

Direct Access is currently limited to RedfinNow listings, but we expect to offer Direct Access to other Redfin listing customers in the next six months. Listings with Direct Access so far seem to get more tours, which may persuade more homeowners to hire Redfin as their listing agent, especially if it improves their odds of selling the home without paying a buyer's agent.

In October, we also expanded Redfin Direct Offers from Boston and northern Virginia to Texas. Direct Offers is our online service for buying Redfin listings via our website without a buyer's agent. Redfin.com guides homebuyers to the terms of their offer, using data from our brokerage customers about the terms that are typical for the area. In the third quarter, we shifted the online forms for preparing an offer from a partner platform to our own software, so we can start improving the rate at which would-be buyers complete an online offer.

In Austin, where we've launched Direct Access and Direct Offers, the whole home buying process can now be self-service: we can let a buyer into a home without an agent, then prompt the buyer after the tour to submit an offer without an agent. Two RedfinNow homes that featured Direct Access have already sold to a buyer unrepresented by an agent, reducing the average commissions paid by RedfinNow by more than $4,000 per listing.

We also expect more consumers to become aware of what a buyer's agent costs, because we're now publishing on Redfin.com the commission that a home seller has promised the buyer's agent. We did this first for homes listed by Redfin, so we wouldn't have to ask our data partners for permission.

Then in October, due to a rule change from the Multiple Listing Service used by Seattle-area brokers to share listing data, we published this data for homes listed by any brokerage in the Seattle area. Other Multiple Listing Services may follow Seattle's example, letting Redfin publish commission rates more broadly.

In a country where many buyers believe their agent is free, this new level of transparency could create the same kind of price-driven marketplace for buyers' agents that already exists for sellers' agents. Over time, that marketplace could benefit a low-price leader like Redfin, especially as we expect to develop new offerings with low prices.

Our self-service capabilities will be an important cost advantage over time for RedfinNow. For the third quarter, RedfinNow improved gross margins from -2.7% in 2018 to -0.9% in 2019, even with revenue growth above 600%. RedfinNow's other cost advantages are our website's monthly audience of 36 million, which lets us avoid spending money to meet homeowners, and our nearly 1,600 real estate agents, who can sell the homes that RedfinNow ends up buying.

But what drives now margin the most is our pricing. If we pay too much for a home, it hardly matters how efficient we've been at acquiring, renovating or selling that home because we wish he hadn't bought it at all.

This is why machine learning improvements we've recently made to the Redfin estimate are so important to RedfinNow's anticipated profits. The Redfin Estimate is Redfin's estimated sale price for more than 85 million U.S. properties. It has been the main draw for homeowners to visit our site, but we also use it to guide RedfinNow offers.

For off-market properties, we expect that the Estimate's median error rate will improve significantly. As part of this improvement, we will also rate how confident we are in the price we project for each home. This will let us flag the homes that are too unique to price with high confidence, which will help RedfinNow avoid risky purchases.

In our last call, we said that demand for instant offers is here to stay, as most homeowners will want to see how much an institutional buyer will pay for their home before listing it. And because it's so important to our whole business to meet homeowners who are deciding whether and how to sell their home, we want to run that sales process, mostly by making the instant offer ourselves. This is why we have expanded RedfinNow since July 1st from 6 markets to 10, adding Boston, Houston, Las Vegas and San Antonio.

But the ultimate proof of RedfinNow's success isn't just in its own growth but in RedfinNow's contributions to the company's overall listing share. Markets that launched RedfinNow in 2018 or earlier have grown listing share about 14 points faster than comparable markets without RedfinNow. This gain in listing share, which we measured by comparing January - September in 2018 and 2019, accounts for the homes our brokerage sells for listing clients and for RedfinNow.

But even though we see RedfinNow as one component of a larger solution, our plan is for it to make money on its own. And we still see profit, not growth, as the fundamental challenge with institutional buying. We're investing more in our capabilities as an institutional buyer to improve RedfinNow's profitability, even as we narrow the range of homes in each market that we buy.

This focus on profits is why we've been conservative in how we measure RedfinNow's gross margins, accounting for both the homes we sold and the money-pits we're still struggling to sell. We've also been conservative about counting every possible field expense against our gross profit: for the home itself; for all the employees who prepare instant offers to buy the home; for repairs and improvements; for taxes, maintenance and listing fees; for all the managers of RedfinNow's field personnel. Since we've set up RedfinNow to make money in the future after accounting for all these costs, we've included those costs in our tally of RedfinNow's present-day gross losses.

We can be more disciplined than other institutional buyers about profits because Redfin's overall share growth doesn't depend exclusively on our buying homes. A homeowner who rejects the RedfinNow offer can list the home through Redfin's brokerage. For homes and markets that RedfinNow hasn't yet reached, we can turn to a partner like Opendoor. In the future, we may also call on partners to buy homes that we don't have the pricing confidence to bid on ourselves, even in markets where RedfinNow operates.

On July 11, we started promoting Opendoor to Redfin.com visitors in two markets that RedfinNow had not yet reached, Atlanta and Phoenix. The number of Redfin.com visitors who asked for an offer has been high, and the number of homes Opendoor ended up buying has met our expectations. There is enough demand for an instant offer from Redfin.com visitors to support RedfinNow's growth and also to support partnerships with other institutional buyers, several of which have contacted us recently about a partnership similar to the one we have with Opendoor.

No matter how much we improve from year to year, RedfinNow's long-term margins are still speculative because the entire i-buying industry still hasn't made any money. Profitability for our mortgage and title businesses is far more straightforward just because each has many stand-alone competitors with well-established margins.

We believe both title and [mortgage] (corrected by company after the call) can be even more profitable when combined with the technology powered brokerage, avoiding the money most lenders and title companies spend to woo brokers, and the cost of sending customer information back and forth between different companies using different software. This is why our Other category of revenues, which consists mostly of mortgage and title sales, improved third quarter gross margin from -14.1% in the third quarter of 2018 to 0.9% in 2019.

Redfin Mortgage's salespeople are already much more efficient than a typical lender's, just because our mortgage advisers work side-by-side with our real estate agents. In one market in September, 24.5% of our homebuyers completed a sale with Redfin Mortgage as their lender. This brings us tantalizingly close to Redfin Mortgage's 2019 goal of loaning money to one in four Redfin buyers in one market for an entire quarter.

We certainly don't expect every market to reach a 25% mortgage attach rate every month in 2020, but the brokerage isn't Redfin Mortgage's only source of business. A surprising number of Redfin Mortgage customers come from outside our brokerage, despite our having made almost no efforts yet to promote Redfin Mortgage to Redfin.com visitors, and anyone else outside of our brokerage.

Because our mortgage advisers can get so many lending customers from our brokerage, we're already more efficient than the average lender. As we improve our loan-origination software, we'll make even more efficiency gains, many in processing, underwriting and closing a loan. For these and many other reasons, we expect the mortgage business over the next 18 months to contribute to the profits already generated by our title business.

But the main engine of our profits is the brokerage, which also got more productive in the third quarter. This is because we're routing more customers from our website to each agent this year, and because U.S. home sales dropped sharply in the third quarter last year.

To drive long-term margin gains, we need to improve the rate at which our homebuyers succeed in buying a home through Redfin. This efficiency gain is also crucial to the company's mission, which is to give people buying and selling a home a better deal. To improve homebuyers' success rate, we'll have to improve our service, but also better qualify the customers on our website.

In seventeen pilot markets, we're now asking people signing up for their first Redfin home tour questions about their home buying-plans. As we plan for our company-wide rollout in January 2020, our hope is that this will reduce the number of new tour requests without significantly reducing sales, so our agents can focus on the customers most serious about buying a home. And in two pilot markets, we increased the rate at which agents follow-up with customers within 24 hours of their first tour by approximately 30%. If we can start next year with a similar change company-wide, we would expect to see homebuyer success rate increase.

We can't say for sure whether we'll get the same results when we roll out these changes to the whole company, but we've never gone into a new homebuying season as well prepared at this stage as we are now. In August 2019, we also launched performance standards that we expect to affect 20% of our agents in 2020; this may increase attrition rates starting next March, but we expect this long-term impact will be an improvement in the overall quality of our workforce and in our service.

Since April, we've been testing new pricing that can, if needed, give us the latitude to invest more in our service and still improve gross margins. For all these reasons, we believe gross margins will keep rising into 2020.

Gains in customers' success rate, coupled with traffic growth and higher Redfin awareness can lift brokerage sales, which lifts sales for each of our new businesses too, all without the significant customer-acquisition cost of a stand-alone lender or title company. As we start to see evidence that each new business can make money, the benefits of a complete solution compound not only for our customers but for our profits.

Customers who use Redfin's website, brokerage, mortgage and title businesses have always loved the value and advocacy we offer at every phase of their move, because the move often comes together faster and easier than it could have before. But combined, those businesses can generate more profit from the customer than the brokerage alone. Margins for our new businesses will, we believe, go up and down over future quarters, but mostly up. And as each new business becomes more efficient by combining with the whole, our profits can improve even faster than our revenues.

Before turning the call over to Chris, let's discuss the U.S. housing market, which is now probably --I've been reading this damn script too long, let me try that again. Before -- did I say dang? I didn't. Before turning the call over to Chris, let's discuss the U.S. housing market, which is now probably healthier than the economy overall. Residential construction contributed to gross-domestic product growth for the first time in eighteen months.

Yes, we should take the headlines about the housing market with a grain of salt in the fourth quarter, just because the comparisons to a dreadful end of 2018 will be so favorable. But most markets are in decent shape in places like Atlanta and Milwaukee where prices have shot up, sales have slowed, just as they did in the coastal markets last year.

Overall, low rates have strengthened home-buying demand at least marginally over the course of the year, and, after accounting for the season, the number of homes for sales is at a five-year low, so we may see broader price gains in the first half of 2020 and the return of bidding wars. The back-and-forth that has been playing out in 2019 wasn't quite as strong as we had hoped when the year began, but it will probably continue for the next six months at least: and here's how it goes, interest rate drops lift demand modestly, an uptick in prices induces builders and homeowners to list more homes for sale, then sales increase but prices soften, beginning the cycle anew. It's not a boom, but it extends the market's long bull run.

Housing benefits so much from low rates that it seems as solid as any sector of the economy can be, given high levels of uncertainty in the U.S. government and the global economy.

With that, let's turn the call over to Chris.

Chris Nielsen - *Redfin Corporation - CFO*

Thanks, Glenn. We delivered another strong top line results quarter and saw improved gross margin in each of our reported segments. Third quarter revenue was $239 million, up 70% from a year ago.

Real estate services revenue, which includes our brokerage and partner businesses, grew 22% year-over-year. Brokerage revenue or revenue from home sales closed by our own agents was up 23% on a 25% growth in brokerage transactions. Brokerage revenue per transaction was down 2% year-over-year, reflecting the continued mix shift towards our listing business and lower average home value as compared with the third quarter of 2018.

Revenue from our partners was up 8% on a 5% increase in partner transactions. Revenue per partner transaction was up 3% year-over-year. The properties segment, which consists of homes sold through our RedfinNow program generated over $80 million in revenue, up from $11 million in the third quarter of 2018.

In October 2019, we began to utilize our new $100 million asset-backed credit facility, which we put in place last quarter. We continue to expect that over time the vast majority of capital to buy homes will come from lenders, using the homes we buy as collateral. Our cash and cash equivalents, including short- and long-term government securities held for sale totaled over $309 million as of September 30, 2019. We are comfortable that this cash balance, combined with our asset-backed borrowing capacity will provide us with sufficient liquidity to fund our future growth for the foreseeable future.

Our Other segment, which includes mortgage, title and other services contributed revenue of $5 million, a year-over-year increase of 92%.

Total gross profit was $53.4 million, up 26% year-over-year. Real estate services gross margin was 35.1%, up 110 basis points year-over-year, primarily driven by a 120 basis point decrease in personnel costs, including stock-based compensation and transaction bonuses as a percentage of revenue.

Properties gross margin was -0.9%, up 180 basis points from a year ago, primarily driven by a 140 basis point decrease in personnel costs, including stock-based compensation and a 40 basis point decrease in listing expenses, partially offset by a 50 basis point increase in the cost of properties, each as a percentage of revenue.

Other segment had a gross margin of 0.9%, an improvement of 1,500 basis points from a year ago as our mortgage and title businesses continue to scale.

Total operating expenses increased 18% year-over-year and represented 19% of revenue, down from 28% of revenue one year ago. Technology and development expenses increased 31%, driven by an increase in personnel costs, including stock-based compensation and higher occupancy and office expenses to support growth in our technology personnel.

General and administrative expenses grew 14% year-over-year, and marketing expenses increased just 2% as we did not run any offline advertising campaigns and saw slower growth in performance marketing channels during the quarter.

Our net income, including stock-based compensation and depreciation, was $6.8 million compared to a $3.5 million net income in the third quarter of 2018. Diluted earnings per share was $0.07 compared with $0.04 one year ago.

Now turning to our financial expectations for the fourth quarter of 2019. Revenue is expected to be between $211 million and $220 million, representing year-over-year growth between 70% and 77%. We expect our properties segment to account for $80 million to $85 million of that revenue.

Net loss is expected to be between $12.8 million and $9.5 million compared with the $12.2 million net loss in the fourth quarter of 2018. Our guidance includes approximately $7.6 million of stock-based compensation and $2.7 million of depreciation and amortization. It assumes, among other things, that no additional business acquisitions, investments, restructurings or legal settlements are concluded and that there are no further revisions to stock-based compensation estimates.

And with that, we will open it up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Tom White with D.A. Davidson.

Russell Philip Rigby - *D.A. Davidson & Co., Research Division - Research Associate*

This is actually Phil Rigby on for Tom White. So just on your mortgage business, is that 1 in 4 attach rate in the realm of what you're targeting long term? We're just trying to better understand unit economics in mortgage. So any color you can provide on, say, average loan amounts or gain on sale that you're targeting would be helpful.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

We're not discussing gain on sale with investors at this point. 25% attach rate is an aggressive target in the near term. But I think we can do better than that in the long term. It depends on great sales execution, but also great pricing. And today, we just have a significant cost advantage over our competitors, which we're partially able to pass on to customers. So I think the real upside on the mortgage business beyond the brokerage attach rate is just the fact that we have 36 million visitors on redfin.com, many of whom are not going to use an agent from Redfin because their uncle or their best friend is a real estate agent, but who would be completely open to Redfin Mortgage. So that team is champing at the bit to have us turn on the big spigot and promote Redfin Mortgage on our website. We still feel that the website is probably under-monetized because the main monetization channel is just the brokerage. So as soon as we can scale to that demand, we will. Today that team is hiring hand over fist, and we just want to protect the culture and the quality of service.

Operator

(Operator Instructions) The next question will come from Jason Deleeuw with Piper Jaffray.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Just from a strategic and kind of how you're thinking about running the business, it seems like with the marketing spend as a percentage of revenue being less, you're better qualifying customers, the performance standards for agents, it seems like there's an increased focus on managing the business for margin versus growth, not that the growth is bad, it's just that it seems like you're more focused on the margin front. So is that the case? And just kind of give us your thoughts on that? And then also the agent productivity that used to be 34 transactions a year, looks like we're going to be around there again this year. What's kind of the target? Or what can we think about -- or just remind us the range that you have for agent productivity?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

So I'll talk about margin versus growth and then, Chris, do you want to address agent productivity?

Chris Nielsen - *Redfin Corporation - CFO*

Sure.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

I don't think we've shifted our tone on margins versus growth. We want both. We've always been clear, though, that we are in a mid- margin business that we have to be disciplined about our cost that we're going to run this business from the cash register whenever we can. There have been investments in new businesses that are somewhat capital intensive, but fundamentally, we want to make sure everyone knows that we know how to make money. So maybe the emphasis on profit was stronger in this call when we talked about RedfinNow. And I think that's because we realize that in the broader space, there are companies that have a higher risk tolerance that are more aggressive about growth in the properties business than we are. We know that everyone is going to want to evaluate an instant offer, but we think we have to be really picky about which houses we buy. So growth is the easy part in the properties business because it's such a novel product. And because it's so easy to sell dollar bills for $0.95. So I think we just have to be really careful when we look at the properties business, which has grown 600% year-over-year that we grow that business in a responsible way. So if you are looking for a shift in tone, it probably came there, but almost everything else is the way that we've always been. And even with RedfinNow, I feel like that's the way we've always been, but the market has just had different view that other players in the space have been more growth oriented, so we wanted to be clear about where we stand.

Chris Nielsen - *Redfin Corporation - CFO*

And then in terms of agent productivity, we are pleased we've continued to see agent productivity tick up in each of the quarters so far this year. That's what we expected, and we increased the number of customers that each of our agents was meeting really starting in the latter part of 2018. The biggest opportunity for that going forward is what Glenn mentioned on the call, and that's just related to homebuyers' success rate, helping more customers get all the way through to a closed transaction. We continue to meet a lot of customers who're really interested in purchasing homes. And we do, again, as Glenn mentioned, have a variety of programs underway to help those customers get through to closings. And that's the biggest opportunity as it relates to improving agent productivity over time.

Operator

The next question will come from Jason Helfstein with Oppenheimer.

Jason Stuart Helfstein - *Oppenheimer & Co. Inc., Research Division - MD and Senior Internet Analyst*

Question then is a follow-up on profitability. Can you expand a bit more about the takeaways from Austin and Boston, just having all those product offerings in one market? And then how you think about expanding that to -- in terms of the all of your markets over time? And then just specifically -- and then on profitability, the business is showing better profitability, broadly, the guidance implies better margins in the fourth quarter. Can you comment, next year do you expect to be EBITDA breakeven for the year or better?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

Jason, we're not commenting on next year. And I want to emphasize that growth has accelerated, and we've gotten more leverage. So hopefully, we can have our cake and eat it too. The main engines for this growth have been in the core brokerage itself, but also in these ancillary businesses, mortgage and title. I think your questions about Austin and Boston relate to direct access to properties, direct offers. That is not going to affect our near-term profitability or even drive near-term growth. It is a long-term bet that we can change in a very fundamental way the real estate market. We believe there's a segment of customers who want full service and there's another segment of customers who want to do it themselves, and we want to have the best product for each. And so that customer segment that wants to do it itself is the new segment, and it's the one we really want to have a leadership role developing.

Operator

The next question will come from Jack Micenko with Susquehanna Financial Group.

John Gregory Micenko - *Susquehanna Financial Group, LLLP, Research Division - Deputy Director of Research*

Glenn, I think in the prepared comments you talked about where you're active in RedfinNow, your market share increases have been greater. And so thinking through that, and it's been a age-old debate, whether this is driving sales or seller leads or not. Do you think it's brand awareness that's driving that market share with RedfinNow in the market? Or do you think you're starting to see real progress in terms of seller leads from being at that instant offer, whether they take it or decide to list it, for instance, anyway?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

I don't think it's general brand awareness that RedfinNow drives. It drives more seller inquiries. Now the controversy around that is when RedfinNow buys a house, it hires the Redfin brokerage to list it. So every RedfinNow home turns into a Redfin brokerage listing. So there's that direct contribution to listing share that is incontrovertible. And there are some customers who contact us about RedfinNow, who I don't think would have contacted us for the brokerage just because RedfinNow is a more differentiated product. So that's just incremental. Where I still think there's upside for Redfin and the other players in the property space is when someone evaluates an instant offer and says, it's actually too low, I'm going to go ahead and list my property. We've really tried to have an integrated sales experience, where right away the real estate agent says, well, let me help you with that. And sometimes, that works and sometimes it doesn't. We're working hard on that, and we've made good progress. But I still want more. So that's the area where I think we can have a more seamless sales experience and a better overall capture rate from the inquiries.

Operator

The next question will come from Ygal Arounian with Wedbush Securities.

Ygal Arounian - *Wedbush Securities Inc., Research Division - Research Analyst*

So I wanted to ask on what specifically drove the decrease in personnel costs in the contribution to the gross margin in real estate services? I know last quarter, you had talked about the increased costs in touring, and I know you're addressing some of that? It sounds like long term as well. Did that help contribute to costs in this quarter? And then maybe talk a little bit about the Redfin Direct expansion? I know you expanded it into Texas and you're looking to expand further over the course of the year, what are your expectations there at this point? And you're starting to close transactions there? And how can we think about how that contributes to growth and margins at least through the end of this year and as much as you're willing to share about next year?

Chris Nielsen - *Redfin Corporation - CFO*

Sure. So let me start with the question on real estate services gross margin. Those did primarily improve related to personnel expenses as a percentage of revenue. And not only did we get improvement in agent productivity that supports staff productivity in the third quarter of 2019 as compared to third quarter of 2018. Part of that, just as a reminder is that the real estate market started to slow down in the third quarter of 2018. And so that was a headwind on productivity over that period of time. But just generally, we were quite pleased with all the staff productivity. And on your question related to home touring expenses, that was a big headwind in the second quarter that was less so in the third quarter. And so we're hopeful that some of the changes we've been making earlier in the funnel to help qualify customers have contributed to that. Time will tell whether that's the entire driver or not.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

On Redfin Direct, it's just a little baby, Ygal. Mortgage was this way 2 years ago and people were wondering if it was going to have a significant financial contribution, and we counseled patience. In the same way, we are counseling patience with direct. We have been pleased at how easy it is to expand. There are some industry headwinds, where we have to make sure that the local real estate commission really understands what we're doing. But it's totally above board, and it's going to expand relatively quickly. I just think the challenge is going to be making sure that people can get through the process of preparing an offer without a real estate agent and really driving completion rate on that form and conversion rate for Redfin listings to turn into sales without an agent. So that will take some time. But I do think the trend is only going in one direction, and it's important that you have a portfolio of businesses with different growth rates and maturities because at one point, a year from now, 2 years from now, 3 years from now, we think this could be a significant driver of profits. It's a very high-margin business segment.

Operator

The next question will come from John Campbell with Stephens.

John Robert Campbell - *Stephens Inc., Research Division - MD*

Congrats on the continued success. But Glenn, I've got one more on direct offers and don't worry we're going to stay patient there. But you guys have rolled that out in, I guess, a handful of markets now, it's only on Redfin for-sale properties. But I think recently, maybe a couple of months ago, you guys started to solicit feedback around basically open that up outside of Redfin and kind of into the broader industry. But I'm curious about how that's gone so far? And what, if any, pushback you might have received?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

John, not a sparrow falls without you noticing it. We're trying to be sneaky about that. Just because our diabolical plans haven't been announced to the world, so at some point it makes sense for us to let other agents, including the agents who have complained about Redfin Direct, put that button on their own listings because it's good for their clients, and it's actually good for their own business. I don't think we're quite ready to do it yet, but the results of the survey you asked about where we asked some agents, would you be willing to do this, were good. Plenty of agents would be interested in doing it.

Operator

The next question will come from Mark Mahaney with RBC Capital Markets.

Michael Chen - *RBC Capital Markets, Research Division - Associate*

This is Mike Chen on for Mark. On properties, gross margin nicely reached a record high. So I was wondering if you could talk about some of the other future levers of expansion for this segment. And when we could possibly think about positive margins? And also on RedfinNow, you've expanded to several new cities this quarter, now you're up to 10. I was just wondering if you had any changed views on the iBuyer opportunity. And how we should think about pace of market expansion over the next several quarters?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

So the properties business is going to be part of Redfin for the foreseeable future. We think consumers are going to want to evaluate that option. I don't know that we're going to be very aggressive about expanding markets because it's so operationally intensive. So we are now branding our own vans and filling them up with vanity counters and sinks and all this other stuff to be able to fix up the houses that we buy. And the faster we get those vans rolling around the city, the less money we have to waste paying for the lawn to get cut and the taxes and maintenance fees and the capital that we borrow to buy the house. So I think our focus is going to be more on gaining share within a market than expanding to other markets. I will probably take a balanced view of that, but it will shade towards concentration.

And then the levers on profit are really the ones that we already discussed. Operational excellence and just grinding on margin are something that we really pride ourselves on because we've been in a cost-sensitive business for so long. We've been a value leader for so long. We view the properties business as a race to the bottom, nobody cares whether the check came from Redfin or somebody else. They care about the amount. And so this is an economic war that we feel well equipped to fight. Having said that, pricing is just so important, if you misprice a house by $5,000 or $10,000, no matter how many efficiency gains you get on mowing the lawn for $55 instead of $60 a week, it just doesn't matter. So that is a software problem. It's a software problem we've been working on for a long time. The fact that our machine learning team just came up with another astounding increase in accuracy for our estimate, we feel good about it. We've also made some organizational changes so that we have more governance on who gets to price the home, how much financial expertise that person has, centralizing some of those decisions and managing by exception has really been beneficial to us. So I don't want to make forward-looking statements about when RedfinNow is going to make money. But I will tell you that we're just very tough on that business. We fold our arms, Chris and I, and say you think you're going to make money? Prove it to me. Because there's so many ways you can baloney yourself on this one. And the addressable market, the size of the market goes up and down, depending on your willingness to take risk and lose money.

Operator

The next question will come from Thomas Champion with Cowen.

Thomas Steven Champion - *Cowen and Company, LLC, Research Division - VP*

Given the de minimis loss in -- at RedfinNow. I'm just curious if it's safe to assume that maybe you're seeing some better profitability in early markets like Inland Empire and maybe San Diego. Just curious, any comment on the profitability of Now in any of your older markets? And then also, notice that in the brokerage business you launched in, I think, Savannah, maybe in Tennessee and Northern Kentucky, these struck me as generally smaller markets. And I'm just curious if your thought on the size requirements in order to support service have changed at all, whether or not you can actually operate the core brokerage business in smaller places.

Chris Nielsen - *Redfin Corporation - CFO*

Let me start with the second question first. So related to real estate services expansion, brokerage expansion, we have added a few markets recently. We'll continue to do that. Mostly those are opportunistic around multiple, Multiple Listing Services that are combining or areas that are adjacent to places we're already operating. So you shouldn't think about our stance with regard to going into many smaller markets is any different. We'll do that opportunistically, but it's not a core strategy for the company.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

And the question about vintages in RedfinNow, our older markets running at higher margins, we're trying not to segment this market-by-market because it's such a crapshoot quarter-by-quarter, market by market, that your results are really going to vary wildly. I think the question we have as we organize markets into cohorts is whether we should do that by vintage, where profits just improve as you gain more market experience or whether we should do that by home type. So if you go to Denver, Dallas, probably Phoenix, it's ground zero for i-buying. You have a commodity product, it's at a reasonable price so you can drive significant volume and that lets you train the algorithms better too. But it's also just a competitive frenzy and then you go into the coastal markets where you have to do more renovations, there's a lot of older properties. But if you fix them up, there's a big gain on sale. So those are almost 2 different businesses. And we have significant traffic in the coastal markets, a bigger brokerage footprint in the coastal markets, and some strong home services capabilities. Just generally, we've invested in that area, both for RedfinNow, but also this business we've talked about in past calls, concierge, where we fix up a customer's home and get more money for the customer. So I think that's the more interesting way to subdivide our profits, and we're still exploring which one of those cohorts is going to be most profitable. Obviously, the coastal cohort is higher risk. So even if you have alpha there, you also have plenty of beta.

Operator

The next question will come from Heath Terry with Goldman Sachs.

Adam R. Hotchkiss - *Goldman Sachs Group Inc., Research Division - Business Analyst*

This is Adam on for Heath. On pricing, it looked like revenue per transaction was down on the brokerage side. Any update to the way you're thinking about the balance between the seller commission reductions and buyer rebates? Or is this more a function of top 10 markets coming down as a percent of total and that continued progress there? And then if you could just delineate, if there's been any change to the level of demand you're seeing from the buyer and the seller side?

Chris Nielsen - *Redfin Corporation - CFO*

Yes. So revenue per transaction was down a bit third quarter versus third quarter last year. If you looked at that sequentially from the second quarter to third quarter, that's pretty typically what we see. So it's partially influenced by types of homes in the market that tend to be in the third quarter. And then there is some pressure from what you mentioned in terms of the top 10 markets as a percentage of revenue headed down a bit over time. But fundamentally, we don't have a different view on what our pricing will look like. We think about it as a combined set of revenue between buyers and sellers.

Operator

The next question will come from Andrew Hargreaves with KeyBanc Capital Markets.

Andrew Rex Hargreaves - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

I wonder if you could provide a little more detail on the performance standard changes you guys are making, I guess, on just the impetus and sort of key metrics you guys will be focusing on? And then how you're expecting that to impact hiring and volume?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

Sure. So the impetus behind these performance standards for our real estate agents is just a broader shift that we discussed some in the last call toward a value-driven sales force. In some ways, I've been the opponent of running a sales force here at Redfin because the whole premise of the company is to be a customer advocate and not to turn the real estate consumer upside down and shake every penny out of her pocket. But we found that we were sometimes too passive when dealing with the customer. So the customer wasn't sure which neighborhood to be in, which home to buy. And we would say, well, just let us know when you make up your mind because we don't want to press you into the wrong purchase, when really we needed to step forward and say, here are 3 neighborhoods that are up and coming. Here are 5 listings that I think would be a really good fit for your family. Let's work on this together. And so having a sales force that is more proactive but still driven by the values of the company to be different than every other brokerage and to take care of the customer and to tell that customer to walk away from the wrong deal is the balance we're trying to strike. It's a huge cultural shift. And I think it's absolutely crucial because for the longest time, the engine of our growth has been our website and most employees at the company, real estate agents, have not had a role in driving growth. They basically have been relegated to some kind of fulfillment role. And they want to be those partners. And so the performance standards are just about being very clear that if you meet a bunch of customers from our website and none of them end up buying a home maybe that was bad luck, but over time, they're voting with their feet and where we become more skeptical is we used to survey customers based on whether they were happy with their agent, and that was the measure of an agent's performance except that all the people who ended up buying a home, filled out the survey and all the people who didn't, didn't fill out the survey. And so I think we take a closed sale as the most sincere expression of confidence in the agent's service and telling the agents that if you're going to meet a bunch of customers who have been sourced from our website you got to keep up your end of the bargain and really knock their socks off. So we look every month at the number of customers they met and how many of them ended up sticking with us and how many ended up successfully buying a home. And if people are way off the budget, we then say this is what's going to happen to you, you're going to go on a performance improvement plan, we're going to try to coach you to do better. But ultimately, we have to ask you to leave. And so I think it'll improve the quality of our workforce and improve the quality of our service and doing everything through programs and more questions on web forms. And everything except a better agent was only going to get us so far. Having a better workforce is going to do wonders for the business, in my view.

Operator

The next question will come from Brent Thill with Jefferies.

Alexander Joseph Giaimo - *Jefferies LLC, Research Division - Equity Analyst*

This is Alex on for Brent. So the reacceleration of revenue growth you're seeing on the brokerage side, can you help us size how much of that you believe is macro improvements over last year versus fundamental share gains? And then I understand you're not going to provide any color for next year, but as we move forward and you comp a year of heavy marketing spend, should we expect some stabilization in brokerage revenue growth?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

Oh, man, tough question. Fortunately, we report on share gains explicitly to try to address the tailwinds and headwinds of the housing market. And some of our revenue growth is driven by that tailwind. We do have a soft comparison to the third quarter of last year, but market share growth is also up. We were doing 10 points -- 10 basis points of share growth a couple of quarters ago for two quarters straight, and now we've elevated that to eleven. So I do think there is durable brokerage share growth that is separate from a tailwind in the market. As for next year, yes, we're going to be comparing ourselves to 2019 when we had elevated levels of marketing spend. But I think we're going to have better sales execution and higher close rates. So with strong traffic growth and awareness that pays dividends over multiple years, I feel reasonably good about next year. I'm trying to say this in a sufficiently vague way that lawyers and investor relations folks want me to, but hot dang, I think we're going to do pretty well.

Operator

The next question will come from Naved Khan with SunTrust Robinson Humphrey.

Robert Charles Zeller - *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

This is Robert Zeller on for Naved. What early positive or negative trends are from consumers using the direct access are you seeing? And what are you learning about consumer behavior here? And is there any color you can provide on efforts to improve conversion rates from tours?

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

The thing that struck me is that they're normal. I remember when we launched Redfin ten, fifteen years ago, the people who first tried our service were some pretty odd ducks. You just had to be a little bit crazy to put your faith in Redfin when it was three or four of us in an apartment. And so I sort of expected that it would be odd balls all over again with Redfin Direct. I wanted to know the profile of the person buying that house, I thought maybe it would be a millennial who grew up buying her textbooks off amazon.com. But it's all been boomers who say I bought 5 houses, I know how this works, saw the place on my own and I know what I want to pay for it. So that's been reassuring to me. I don't know that we have such a chasm to cross demographically because young and old folks have been using this product. I almost feel more mechanically as I don't know how many screens there are, I forget, but there are a lot. And the drop from screen to screen to screen is something that a product manager and engineer just loves to geek out on, where you work harder and harder to improve that, and it's a very straightforward problem. So I'm sure that their cultural issues we'll have to address, but the most straightforward one is just to make the web form better.

Operator

The next question will come from Josh Lamers with William Blair.

Joshua Kapler Lamers - *William Blair & Company L.L.C., Research Division - Associate*

At this point, most of my questions have been asked. So maybe I'll just double back on hires. Hoping you can walk us through your expectation for agent hires in 2020? Maybe how we should weight your comments about a better housing backdrop and the potential for agent attrition in 2020? And also, if you're focused on the top 10 markets or more broadly based, that'd be helpful.

Chris Nielsen - *Redfin Corporation - CFO*

Sure. So generally, in terms of hiring agents, we do that based on the demand we're seeing in those local markets. We've already put together projections for what we expect in all the places in which we operate and we'll hire into that. In the early part of the year and then as we get into February and March, we'll adjust hiring based on what we're actually seeing for those final sets of hires. So you shouldn't expect that we approach hiring in any different way this next year than we did in the past several years. It's based on the demand that we see.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

I think we're getting better candidates for what it's worth.

Chris Nielsen - *Redfin Corporation - CFO*

Yes.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

The brand awareness has helped, the share gains have helped, the income difference really matters. Our agents are earning a good living.

Operator

The final question will come from Ryan McKeveny with Zelman & Associates.

Ryan McKeveny - *Zelman & Associates LLC - Director of Research*

So one quick follow-up on a couple of questions ago about the performance standards. I'm curious, does that entail any change to the actual compensation structure with agents like the kind of split between salary and bonus? And then just a separate question. I'm curious, a total separate topic, but on the i-buyer side of things, with the markets with the Opendoor relationship versus your own markets, I'm just curious, is there much of a difference in either the agent or the consumer experience, anything you're learning from just doing it in the partnership fashion versus doing it yourself with RedfinNow? Any comments along those lines would be very helpful.

Glenn Kelman - *Redfin Corporation - President, CEO & Director*

Sure. So we have not made major changes to the compensation plan. There is a new level called principal agent for some of our best-performing agents. And that rewards not just productivity or customer success rate, but also customer loyalty. If you've been at Redfin for five, six, eight years as an agent you often can be off the website for six, nine months out of the year because so many customers are asking for you by name, they're referrals it's repeat business and all the rest. So we want those agents to earn a premium because they're so profitable for us and recognizing them as principal agents is probably the harbinger of other changes where we continue to encourage our agents to use the website to build a book of business, but then also invest in that book of business over time, where they check it in on clients or sending holiday cards because, obviously, online loyalty programs can be effective, but it makes a difference when your agent's in the neighborhood and stops by to say hi. As far as what we've learned from Opendoor, it's just that they put together their offer faster. We're very careful about how much we're willing to pay, and I'm sure Opendoor is too but that process for them is more efficient than it is for us. And I can only assume that it helps drive offer acceptance rate. So that has driven us to raise our game. Those guys have been doing instant offers for a long time, and they really put the instant in instant offer.

Operator

Speakers, there are no further questions at this time. I'll turn it back to you for closing remarks.

Elena Perron - *Redfin Corporation - Head of IR*

Thanks, Brandon, and thanks, everyone, for joining us today. We appreciate your interest in Redfin, and we'll speak with you again next quarter.

Operator

Thank you, ladies and gentlemen. This concludes today's event. You may now disconnect your lines.
