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PRESENTATION

Operator

Good day, and welcome to the Redfin Corporation Fourth Quarter 2017 Earnings Conference 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 Investor Relations*

Thank you, Cassy. Good afternoon, and welcome to Redfin's Financial Results Conference Call for the fourth quarter and full year ended December 31, 2017.

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 this call, the financial metrics, unless otherwise noted, will be presented on a GAAP basis and include stock-based compensation as well as depreciation and amortization expenses. You will find reconciliations of non-GAAP measures discussed today to the most comparable GAAP measures in our earnings release. 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 year-over-year market share gains continued to accelerate in the fourth quarter, and our revenues exceeded the range we gave you last November. More importantly, we invested in fundamental improvements to our customer service while reducing our loss from the fourth quarter of 2016 to the fourth quarter of 2017.

Our fourth quarter revenue was $95.8 million, an increase of 43% over the fourth quarter of 2016. A more fair comparison excludes new businesses to consider only the sales through our own agents and our partner agents. These revenues were up 36% over the fourth quarter of 2016. Excluding revenue from new businesses is especially important because our new experimental service for buying homes outright from consumers, Redfin Now, counts the entire sale price of a home as revenue, even though our gain on the sale is only a tiny fraction of that price. Our first Redfin Now sales closed in the second quarter of 2017.

We still lost money for the quarter and the year. While this was by design, we have to soberly account in this call for what we're buying with those losses: technologies to make our brokerage better, faster and more efficient; new products to broaden our customer appeal; new businesses to give each customer more value. I've never worked so long in a business where there are still so many ways for it to grow.

The most important measure of our performance is our customer satisfaction. In a November 2017 survey of nearly 2,000 Americans who worked with an agent over the past year to buy or sell a home, Redfin's net promoter score was 52% higher than traditional agents. A net promoter score is a measure of customer satisfaction. This was the fifth consecutive survey in which Redfin's customer satisfaction was higher than our competitors.

Our market share by home value was 0.71% in the fourth quarter, the same as in the third quarter, but a gain of 0.15 percentage points over the fourth quarter of 2016. Year-over-year share gains accelerated steadily throughout 2017 from 0.10 percentage points in the first quarter to 0.11 in the second, 0.14 in the third and now 0.15 in the fourth quarter. We believe that share is the best measure of our competitive position because it excludes the housing market's ups and downs.

As we predicted in our last 2 earnings calls, traffic growth moderated in the fourth quarter, mostly because our audience has become so large in absolute terms. But redfin.com continued to be the U.S.'s fastest-growing real estate website. Our year-over-year growth in online visitors was 33% in the fourth quarter compared to 38% in the third quarter. We expect strong traffic growth in 2018 but with percentage gains continuing to moderate. Beyond 2018, we believe our traffic growth will come from the 77 markets that Redfin opened less than 10 years ago, from Google searches on real estate terms where we haven't been competitive before and, as Redfin becomes more well known for listing search, from more people bypassing Google to come directly to our site. We also expect that our business will depend less on our growth as a listing search site and more on our growth as a brokerage, with gains in repeat customers continuing to accelerate and more people coming to Redfin for on-demand home tours and lower fees.

More advertising is also likely to contribute to our growth. As our conviction deepens that we offer the best service, we want America to know about it. In the fourth quarter, we prepared the most comprehensive marketing campaign in Redfin's history, with our first major radio and billboard ads both promoting our 1% listing fee. To illustrate the power of on-demand home tours, we also developed a new TV ad that shows a couple instantly moving from one listing to another via magic doors activated by our mobile application. Starting February 5, these ads began to run in more than a dozen U.S. cities.

Beyond traditional media, we plan to continue drawing on our unique data about which online visitors actually buy or sell a home. This will let us make better investments than we believe any broker can in online video, search engine ads, retargeting and other digital media.

Finding advertising channels that we can profitably spend lots of money on continues to be a strategic priority for Redfin. Most of our potential customers still don't know about us. In November 2017, we asked thousands of people buying or selling a home in long-established Redfin markets to name their top 3 real estate websites. Less than 1 in 3 named redfin.com. When asked to name top 3 brokerage, less than 1 in 10 named Redfin, even in markets where we've run TV ads for 3 years. One of the only reasons we may defer improving profits every year is to spend more on ads. We spent 20% of 2017 gross profits on advertising placements, but if we find a winning formula, in 1 year, we might spend nearly double that percentage to get our name out there. Those ads aren't going to be immediately profitable, given that it typically takes 6 months to buy a home once you engage an agent and that many of the people who see an ad will be years away from moving. No mass-market advertising is going to pay for itself the year it runs. Even if an ad doesn't bring us enough customers to immediately offset its expense, our bet would be that we'd benefit from the increased awareness for years to come.

Over time, our ad spending would grow much more slowly than our business, likely returning to between 10% and 20% of gross profits. But if this increased awareness accelerated listing share gains, it could create a virtuous cycle with yard signs reinforcing other forms of advertising.

Already, we've seen evidence that we may be able to create this virtuous cycle in Seattle, where we have a hometown advantage but also the highest listing share. Nearly 1 in 5 Seattle real estate consumers named Redfin as the top 3 brokerage, which is double the rate of our next best market and significantly higher than it was 6 months ago. We'll have data from our 2018 campaign across many markets by August, and we'll let you know if Seattle's awareness gains hold up and broaden to other markets.

For homebuyers, the simplest benefit we can tell in our ads and on our site is speed by instantly scheduling home tours, and we're getting faster. We updated our scheduling software so that we could automatically find the time for an agent to meet a customer on 83 -- excuse me, 83% of our December home tours, up from 68% in September. Confirming a tour request without any phone calls between coordinators, agents and customers lets us capture more would-be customers with less work. Just as a retailer increases revenues through elaborate systems to get the right products to the right shelves, we've worked for years to ensure the right Redfin agent is available for each customer at the right time.

The next step for us is rapidly confirming the availability of the listings the customer wants to tour. Typically, the buyer's agent calls the seller's agent to see if the owner can get the house ready for a showing. But starting in the third quarter, Redfin began using a combination of software and call center employees to do this more quickly and efficiently. By the last week of December, we confirmed 9% of home tours without requiring a Redfin buyer's agent to do anything except show up. A major 2018 focus will be confirming listing availability for nearly all tours. Our goal over time is to convey a competitive advantage, not just to Redfin, but to our homebuying customers, who should never have to wait on an agent to see a hot listing.

This commitment to speed is why we've also invested in our own offer writing software, which lets our agents put together a bid on a listing in a few minutes. In the fourth quarter, we expanded the markets the software supports from Chicago, D.C. and Virginia to Maryland. The localization involved for each market is extensive. Different states, counties and cities require different offer forms, and local customs around earnest money amounts and other deal terms require different default values for the forms field.

In Maryland alone, we have to support 30 addenda. For these reasons, it will take us years to adapt our offer writing software to every major U.S. market. But as we do, we believe we'll be able to move faster than any other broker at lower cost and with comprehensive data about what it takes to win in each neighborhood.

Even as we automate the opening and closing stages of the homebuying process, we're investing in more personal service during the long search in between to give our homebuying customers more guidance on how to win in an increasingly competitive market. As we discussed in our last earnings call, we want shareholders to understand this investment, which is a bet that spending more on our service could not only lead to happier homebuyers and more sales but ultimately to more gross profits per sale. For that bet to pay off, we'll have to buck an increasingly competitive market. When home prices rose in the last boom, easy lending standards and lots of new construction let homebuyers keep up, but now that the market is so much tighter, our job as agents is to work harder at finding a way for each homebuying customer to win.

Over the years, the number of customers that a Redfin agent has met in order to generate 1 sale has varied widely as we've made changes to our service, which tells us that what we do can increase or decrease our customers' rate of success. And since most of the customers our agents spend time with don't end up buying a home with us, we know that any improvements in our customer success rate can save our agents plenty of time. The stakes for customers are even higher as our service can be the difference between winning or losing a house. In an industry where referrals and repeat sales are so important, we believe the only way to be America's most successful brokerage is to have the most successful customers.

Our investments in personal service began in the third quarter of 2017, with modest agent hiring in a season when we usually hire no agents whatsoever. But then in the fourth quarter, we developed an entire program for asking agents to meet homebuying customers more often and to give those customers more substantive data-driven advice. Coming into 2018, Redfin plans to lower the number of homebuying customers each Redfin agent supports by 10%, hiring more Redfin agents than we would have in 2017. The ratio of customers to agents will still be slightly lower than it was in 2016, a year when our buyers' agents were nonetheless more productive than in 2017. If this new level of personal service doesn't make our customers more successful in 2018, agent productivity and profit per transaction will decline.

But the dwindling number of homes for sale notwithstanding, we have reason to believe our 2018 homebuyers will in fact be more successful. In 2012, when the market first swung sharply in sellers' favor, reducing the number of buyers supported by each Redfin agent increased our customer success rates. We saw the same correlation in 2017. The agents who served fewer customers had higher customer success rates. We've also been encouraged by more recent developments, including a successful trial last fall of coffee shop strategy sessions with our customers for comparing the terms of winning and losing offers.

To help our agents give customers more personal service, we also upgraded our software with a new online calendar that shows an agent what's going on with each of our customers this week, whether that's a home tour or negotiating deadline or a closing. Other software released in the fourth quarter made it easier for Redfin agents to focus on customers who most need attention based on the customer's online search activity and brokerage interactions. This lets our agents immediately see the customers who signed up for one tour with Redfin, but not a second, or which customers have engaged a Redfin agent without subscribing to alerts for new listings in their price range. We developed this software using the React JavaScript library, pioneered by Facebook for high-performance and easy porting from desktop browsers to native mobile applications. We know of no other brokerage taking such an aggressive approach to mobile software for ensuring that on-the-go agents deliver the right service to each customer. By the second quarter of this year, we'll get our first data on whether these new programs and online tools help more buyers win an offer and what the effect will be on profit per sale.

We're also working hard to serve home sellers better, primarily through lower prices. At the beginning of the fourth quarter, we lowered our listing fee for a full-service Redfin agent from 1.5% to 1% in 18 markets -- excuse me, 18 additional markets. We offset that savings with a fee increase for our homebuying customers by refunding a smaller portion of our commission as a buyer's agent. The 1% fee is now available in a total of 26 markets, which accounted for 87% of 2017's brokerage transactions, but we do not expect to expand it further anytime soon as home prices are too low in the remaining 60 markets for it to be viable. At the beginning of 2017, 1% pricing was available in markets that accounted for 54% of our transactions.

Years of testing in Washington, D.C., then in Seattle, Chicago, Denver and San Diego have shown that this pricing increases our overall share, and it's easy to see why. Sellers contractually agree to a fee in advance when hiring a seller's agent, whereas buyers have treated our commission refund like the tooth fairy. They're skeptical or oblivious until discovering the money as if under their pillow only once they've closed and months after meeting their Redfin agent. The 1% fee is also easier to promote in ads and on redfin.com.

We're also exploring other ways customers can benefit from our efficiency by experimenting with a level of service that we believe no brokerage has been able to consistently deliver before at a fee that is still lower than the commission typically charged by traditional agents. We call this our Redfin Concierge Service and charge a fee of 2% rather than 1% to coordinate and pay for staging and other cosmetic improvements that we believe can increase the final sales price. Redfin Concierge is only available for homes expected to sell for $500,000 or more.

We began testing the service in Los Angeles and Washington, D.C. to see if it can broaden our customer appeal and also to determine if the 2% fee covers our cost. We expect it will take at least a year to iterate on the offering and how we market and sell it and then to see how customers like it.

The second experimental offering for selling our customers' houses is Redfin Now, in which Redfin buys a consumer's home outright, letting the owner move on with cash in her pocket, while we try to spruce up the home to sell it at a profit. The owner typically nets less money than she would by hiring a Redfin agent, but gets this money sooner with more certainty and less hassle.

Redfin Now began buying homes in January 2017 and recorded our first sale in April. We've limited ourselves to affordable parts of Southern California and did no more than $10 million in home purchases at any one time either on our books or under contract to be bought by Redfin. As we said in our last earnings call, we're no longer divulging exact transaction counts.

In the fourth quarter, we sold nearly all the homes we'd already bought before, with the remainder under contract to sell by the end of this month. We also continued to get plenty of opportunities throughout last quarter to buy more. But at the same time, we experimented with paying homeowners less for their homes in an effort to -- excuse me, in an effort to widen our profits on the subsequent sale. It didn't work. More homeowners rejected our offers, and we bought far fewer homes in the fourth quarter of 2017 than the 19 we reported in the third quarter.

In January and February, we're now paying slightly more for Redfin Now homes and completing purchases at a brisk pace. But since we came into the first quarter of 2018, with few homes to sell, we expect fewer sales. That said, it now seems likely that purchase activity will continue to accelerate. So by the second or third quarter of this year, we expect to allocate $20 million rather than $10 million for purchasing homes from consumers. Given our success so far at selling all the homes we've bought, we view this as an acceptable risk.

We still haven't hired enough engineers and businesspeople to run Redfin Now at any scale except as an experiment, but we'll continue to run it as such, evaluating each quarter, whether Redfin Now can appeal to more than 10% of would-be home sellers at prices that compensate us for our risk.

The other new business we wanted to update you about is Redfin Mortgage, which we launched in the first quarter of 2017, to issue loans to our homebuying customers. We believe integrating a lending operation with Redfin's existing brokerage and title businesses, all running off our own software, can ultimately lead to an entirely digital closing, where Redfin borrowers can compete almost like cash buyers. As with Redfin Now, we're no longer disclosing exact transaction counts. But we were pleased to see loan volume increase during a season when purchase is slow. Fourth quarter loan volume in Texas grew by nearly 40% over the 13 loans we closed in the third quarter, in large part because Redfin Mortgage advisers worked harder to pre-approve loans faster and connect with our customers and our agents on nights and weekends, when deals usually come together. We also expanded to a second state, Illinois, where we closed a few loans. And near the end of the year, we expanded to Washington, D.C.

And with that, I'll turn it over to Chris.

Chris Nielsen - *Redfin Corporation - CFO and Principal Financial & Accounting Officer*

Thanks, Glenn. We finished 2017 with solid fourth quarter results that were above our guidance range. Revenue was $96 million, including a $5 million contribution from Redfin Now. Our revenue grew 43% year-over-year. Real estate revenue, which excludes Redfin Now, Mortgage and other services, was $89 million and grew 36% year-over-year. Brokerage revenue, or revenue from home sales closed by our agents, was up 37%, driven by a 34% growth in brokerage transactions. Revenue per brokerage transaction grew 2% year-over-year. We reduced our sell-side commissions to 1% in 18 additional markets the beginning of the fourth quarter. To offset this reduction in brokerage revenue, we reduced refunds to homebuyers, doing so slightly ahead of the continued mix shift to our faster-growing listings business. Revenue from our partner agents grew 24%, driven by 20% growth in partner transactions and a 3% increase in revenue per partner transaction. Other segment revenue of $7.1 million was up from $1.6 million in the fourth quarter of 2016. This revenue includes Redfin Now sales as well as revenue from title services, mortgage originations and other products. We had no revenue during the fourth quarter of 2016 from Redfin Now or mortgage originations. These businesses are new.

Gross profit was $29 million, up 37% year-over-year, including a very small contribution to gross profit from Redfin Now. Gross margin on the combined partner and brokerage business, known as our real estate segment, was nearly flat, increasing 10 basis points from 33.4% in the fourth quarter of 2016 to 33.5% in the fourth quarter of 2017. This was driven by a 59 basis point decrease in personnel expenses, a 30 basis point decrease in occupancy expenses and a 19 basis point decrease in stock-based compensation. It was partially offset by a 50 basis point increase in transaction bonuses and a 33 basis point increase in tours and field events.

We continued to invest in the businesses accounted for in our other segment, including Redfin Now, Mortgage and title services. We don't break out the results for these businesses, but combined, they lost $524,000 in gross profit compared to a gross profit loss of $475,000 in the fourth quarter of 2016.

Operating expenses showed continued leverage, growing 18% year-over-year, representing 33% of revenue, down from 40% of revenue 1 year ago. This reflects our continued commitment to growing our fixed costs slower than revenue, and we expect this trend to continue into 2018.

One note is that we recorded a $1.8 million expense during the fourth quarter of 2016 for a pending legal settlement.

Our net loss, including stock-based compensation and depreciation, was $1.8 million, an improvement from a $5.3 million net loss in the fourth quarter of 2016. The new tax regulation had no impact on our fourth quarter earnings because we currently hold a full valuation allowance against our deferred tax assets and liabilities.

Diluted net loss per common share was $0.02 for the fourth quarter of 2017, compared with an $8.08 diluted net loss per common share in the fourth quarter of 2016. The prior year loss was primarily driven by the fair market value feature of our redeemable convertible preferred stock which converted to common stock in connection with our IPO. Excluding the impact of the redeemable convertible preferred stock, which is now converted to common stock, adjusted diluted net loss per common share for the fourth quarter of 2016 was $0.08. Adjusted diluted net loss per common share included stock-based compensation.

Before I move to our 2018 outlook, I'd like to briefly recap our full year 2017 performance. Our customers booked over $21 billion in real estate transactions. Compared to a 5% commission, we saved our brokerage customers over $121 million. We delivered full year revenue of over $370 million, up 38% year-over-year and gross profit of over $111 million, up 35%. Our total operating expenses grew 21%, and net loss for the year narrowed from $22.5 million in 2016 to $15.0 million in 2017.

Now turning to our financial expectations for the first quarter of 2018. Revenue is expected to be between $74.6 million and $78.4 million, representing year-over-year growth between 25% and 31%. We expect Redfin Now to account for $2.3 million to $3.1 million of total revenue. Net loss is expected to be between $38.7 million and $35.9 million compared with a $28.1 million net loss in the first quarter of 2017. As a reminder, our losses are seasonal, driven in part by the timing of our revenue. From 2015 to 2017, between 15.4% and 16.2% of our full year revenue came in the first quarter. And March is, by far, the largest month of the first quarter given the seasonal ramp. It's also the month that we have the least revenue visibility to as we speak today. This guidance includes approximately $4.5 million of stock-based compensation and $1.8 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 up to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Jason Helfstein with Oppenheimer.

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

Fully understand the comments around productivity for 2018, but can you give us some more color around what type of assumptions you're making for turnover in the first quarter? Do you -- are you assuming it gets worse and then just overall outlook? And to the extent that you have figured out that there's a productivity -- or that you could increase your clients' success rate with more support, how are you seeing the rest of the industry reactions? Obviously, buyer conversion rate is far down in this environment.

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

Jason, this is Glenn. I just wanted to make sure I understood your question. Were you asking about turnover in agents?

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

No, no, no. Housing turnover, housing sales, the macro.

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

Understood. So we expect inventory to continue to decline and that the market will continue to get more competitive, as I said in the prepared remarks. We do think, though, that we can increase close rate modestly over the next 12 months. And the reason we think that is that every time we've made a change like this in the past, we've had a similar effect. So if you look at cohorts of agents who had fewer customers in 2017, you see that those agents closed at a higher rate, even if you look in markets where inventory was extremely low. If you look at years where it was also a strong seller's market, but we limited the number of customers each agent met, we saw higher close rates. So I think this is going to have a positive impact on close rate. What isn't understood is how positive that will be. So the market is going to work against us, and we're just going to fight the tide.

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

And then do you have -- maybe share your -- are you willing to share any technology road map of additional products coming out that can help agent productivity, in addition to what you said in the prepared remarks?

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

Well, we try to understand that in 2 different ways. There are ways to save agents' time and then there are ways to increase close rate. And most of our labor-saving software is really focused on the support staff because those folks are performing a high number of repetitive tasks where we can either automate it or simplify it so that we can take $10, $20, $50, $100 out of the deal by just having fewer support staff per agent. But with the agent, the name of the game is really to increase close rate. And the way that we do that is giving agents better tools to serve our customers. So if you notice that a customer is online on our website, but just hasn't been active with the brokerage, that's a signal that you probably need to reach out and see what's going on. If you notice that the customer is searching often but hasn't set up online alerts, that's a sign that you need to do that for the customer. So I think most of the software that we're developing over the course of this year is to personalize the service so that we know more about what that customer needs at any given moment and can be there to deliver that service at the right time. And we think that it can significantly increase close rate because we still spend most of our time with people who don't end up buying a house.

Operator

We'll take our next question from Mark Mahaney with RBC Capital Markets.

Mark Stephen F. Mahaney - *RBC Capital Markets, LLC, Research Division - MD and Analyst*

I just had a question about what's implied in the March quarter guidance. Making a reasonable range of assumptions, it looks like you're predicting that real estate revenue is going to grow high teens, maybe to low 20s, something like that, which is a pretty sharp deceleration from the growth over the last 4 quarters. Is that really all due to macro conditions? We've seen the January housing supply indicators get tougher. Is that -- and -- is that what's really driving it? So just spell that out a little bit more. It seems like a pretty drastic deceleration in the growth rate.

Chris Nielsen - *Redfin Corporation - CFO and Principal Financial & Accounting Officer*

Sure, Mark. This is Chris. So we've obviously reflected the best information we have right now into our Q1 guidance. It is fair to say that the year started more -- with a more challenging macro environment than we'd otherwise might have expected. As you also noted NAR reported January transaction volume was down 2% from January of last year and inventory levels are about 10% lower than last year. And so that's certainly what we've reflected in our guidance. As the quarter continues to progress, we have had some encouraging signs over the last couple of weeks, and we've reflected that in our guidance as well.

Mark Stephen F. Mahaney - *RBC Capital Markets, LLC, Research Division - MD and Analyst*

And the time it would take some of these productivity improvements to offset those more challenging macro conditions, you think those are -- is that quarters? Is that years?

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

It will take at least 6 months. So we didn't initiate this program just to accelerate revenue in the first quarter. We did it to make our customers more successful. We did it to make our business more efficient long term. And so we trained people in February. We'll continue to do so in March. And that should have us well prepared for the heart of the homebuying season, which comes in the second and third quarters of the year. So we don't expect to give you an update on whether the program is working until our second quarter earnings call.

Operator

(Operator Instructions) And we'll take our next question from Brent Thill with Jefferies.

Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Glenn, just on, yes, some of the comments around the ad campaign. Certainly, many of us still live in the Bay Area have seen the billboards. Just curious, from a quarter or 2 back, are you finding this to be a more expensive endeavor than maybe originally planned and you -- did you plan on accelerating these investments on the advertising side or has this been kind of in the books? I know you mentioned this is the largest campaign that you've run. I'm just curious if you could kind of walk through how you're thinking about the expense structure.

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

So the expenses don't really deviate from what we planned, at least for 2018, but we do see upside in future years to invest more aggressively in advertising and drive faster growth than we'd expected. So we just wanted to put everyone on notice that if we see that opportunity to grow faster, we'll take it. And the reason that we have increasing confidence in advertising is because we have started to see some durable awareness gains from ads that we ran last year. We have a campaign that we really believe in. The simplicity of the 1% message lends itself well to billboards and radio ads. And we think it's really going to result directly in more sales. So just having seen some encouraging results, we wanted to maintain our discipline this year, but also let everyone know that there is the possibility that we will invest more aggressively in the future. So that is the most likely outcome that we would see an opportunity in future years. It's also possible that we would say, "Actually, this is going so well. We want to invest more aggressively now." But that's not what we had in mind when we prepared the remarks. So our main thesis was that, in future years, we could see a larger opportunity to advertise. So we just need to get some early returns and then make a judgment.

Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Okay. And just to clarify the deceleration in the guidance. I just want to be clear. That is largely related to more the challenging macro conditions versus any internal execution on the internal team?

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

Well, we ask ourselves every time there's a slowdown or a pickup, "Is it us? Or is it the market?" And sometimes it's us. And sometimes it's the market. But in this case, we believe that the market has become more challenging, that U.S. sales volume was low in January, as Chris had noted, that inventory is low. And so we're trying to take measures to grow despite that, and that's why we focus so much on share. When you will see us really become troubled is if we start seeing market share gains significantly decelerate. It's always going to be somewhat sawtooth, but over quarters, halves, years, we expect market share to grow fairly steadily. And so that's why we focus on that and not the ups and downs for the market. Chris, do you want to add anything to that?

Chris Nielsen - *Redfin Corporation - CFO and Principal Financial & Accounting Officer*

No. I think, Glenn, you said it very well.

Operator

We'll now take our next question from John Campbell with Stephens.

John Robert Campbell - *Stephens Inc., Research Division - VP and Research Analyst*

Just wanted to take a quick second on the sell-side listing fee. Glenn, it sounds like you guys aren't planning on doing the 1% across the board anytime soon. But just 2 questions. Do you ever envision a day where that 1% would be across the board in the U.S.? And then I guess, secondly, as the industry starts to mimic your pricing, do you ever envision maybe even going below that 1% percent mark?

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

Interesting question. So first of all, we are always focused on lowering our cost of goods sold so that we can expand our addressable market, sell homes that are very inexpensive and still make a profit or pass the savings on to our customer by offering 1% to more markets. But I don't think we'll do that in the next 6 months or 12 months. That's a long-term grind to make that pricing work in places where homes sell for $150,000 a year. We do think that more competitors are going to try to match that price. That is obviously ground on which we like to fight because we've been so focused on efficiency for so long. So if the market begins to agree that consumers really care about price, I think that's a world where Redfin can really prosper more than any other brokerage. To go below 1% is possible. I think you have to start thinking about other ways to sell houses that aren't so labor-intensive. A long time ago, for example, we asked customers to host their own open houses. And back in that day, they did not like it. They want us to be there, putting the directionals out on the corner and bringing in flowers and everything else. So I think it's possible that there is a new type of customer out there who wants a new product, but I would think about pricing that's significantly below 1% as inviting a new listing product. It would be a counterpart on the other end to the concierge product that we developed, which really is serving a customer who wants just a new level of convenience. And we thought we could take the economic advantage we've developed to actually let us invest more in the house, more in the service than other brokerage traditionally have. So we would just take that and look at it a different way if we were to try to go significantly below 1%.

John Robert Campbell - *Stephens Inc., Research Division - VP and Research Analyst*

Okay. That's helpful. So it just sounds like maybe less touch, less service, less field cost could allow you to do a little bit less than 1%?

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

I wouldn't do something like that for a little bit less than 1%. We would do that probably if we wanted to offer a new product at a new price. But it's really speculative right now. It's not as if we have some diabolical plan to do that next week that we just haven't told you about. We just rolled out 1% to almost all of our customers, and it's having a very sharp effect in 2017 and even in 2018. So I think we need to let that play through before we say, "Here's what we're going to do next."

John Robert Campbell - *Stephens Inc., Research Division - VP and Research Analyst*

Okay. That's helpful. And then one more if I could squeeze in. On the productivity, I guess, the transaction per lead agent, it just sound like a lot of that is kind of end market-driven. You guys back to back quarters of declines. You had a long stretch of kind of gains there, but if we just excluded the market impact, what do you think the -- like peak production per agent can possibly be on total transactions per year?

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

Well, in what market? In this idealized market, it's a perfectly balanced market with 6 months of supply, I think it's sort of hard to hypothesize on what agent productivity could be in a market that isn't today's market. We certainly think that agent productivity can increase. That's why we come to work every day, is to make real estate better and more efficient and to make an agent's job easier so that we can give customers better value. But we're not sharing our forward-looking projections on where we want to take agent productivity.

Operator

(Operator Instructions) And we'll take our next question from Heath Terry with Goldman Sachs.

Heath P. Terry - *Goldman Sachs Group Inc., Research Division - MD*

Glenn, curious, we saw a little bit of an increase in revenue per transaction or revenue per home sold in the brokerage part of the business, which is pretty counter to the trend that we had seen over time. How much of that -- what should we think about as being sort of the underlying drivers from that -- for that? Is it an increase in the value of the homes being sold? Is it a function of moving up market in certain areas? And then as we think about the efforts around driving more traffic to the site and sort of brand-building, should we expect that that's largely going to take the form of television advertising? Or do you see opportunities in online beyond the performance-based advertising that you've been doing thus far?
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Glenn Kelman - *Redfin Corporation - President, CEO & Director*

Well, let me take the first question first. I may ask Chris to weigh in with some additional detail. But the pricing or the revenue per transaction is really a function of mix shift. So we save customers a lot of money when they sell a house through us. We save them a still significant, but less money, when they buy a house through us. And so we're always calibrating our pricing, especially the refunds that we give to buyers, there's a commission that's paid to us as the buyer's agent, and then we give a portion of that to the buyer. And we change that amount as the mix shifts towards listings. So we're trying to keep revenue per transaction steady quarter through quarter through quarter. And if the listing business grows a little faster than we expected, then we have to lower the commission refund a little faster than we expected. And so what you saw happen now is just pricing ahead of that. So we know that listings are going to continue to grow very quickly, and we wanted to price ahead of that. And I would expect that, that will neutralize as listing share catches up to that so that revenue per transaction basically remains constant. And what that means is that much of our gross margin upside comes from lowering cost per transaction, not trying to increase prices on the consumer. I think it's possible that we can move up market. Generally, as we do that, we also move down market. We're fairly acquisitive about share. And so if we sell more expensive houses, it gives us a little bit of latitude to also take on customers who are buying more affordable houses, too. Chris, do you want to add anything to that?

Chris Nielsen - *Redfin Corporation - CFO and Principal Financial & Accounting Officer*

Just one more comment echoing what you said, which is there is some movement quarter to quarter with regard to revenue per brokerage transaction, and it has to do mostly with mix. Over longer periods of time, you can see that balance out a little bit. So for all of last year, revenue per brokerage transaction was actually quite consistent with that from 2016 at just over 30 -- or $9,400.

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

And then to come to your second question, Heath, just about the shift from traditional media to digital. Everyone sees that coming. More people are spending more time online. It's just that the major Internet platforms are pricing that into their ads. So we will probably see some of our media move online, but we're still definitely interested in learning about all the ways we can reach people through traditional media. So we've just begun with radio and outdoor. And the reason we did that is we just thought we had such a good message for, say, a billboard. Everyone should just know in a town that you can sell a house for 1% instead of a 2.5% or 3%. And a billboard is the perfect way to get that out. So we wanted to try it.

Heath P. Terry - *Goldman Sachs Group Inc., Research Division - MD*

Great. That's really helpful. And to the extent the best way to think about your performances is the share gains that you're seeing, any change in your view or your perception of sort of where those share gains are coming from? Who was losing that share to you?

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

I don't think there's really been any change. There's certainly some new competitors, but we haven't really seen a change in the dynamics around market share.

Operator

(Operator Instructions) We'll now take our next question from Jason Deleeuw with Piper Jaffray.

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

Yes. So I just want to make sure I understand how the seller mix, which sounds like it's still growing as an overall mix versus the buyer mix, how the seller mix actually impacts the gross margins of the business. Could you have higher agent productivity because you're more or less guaranteed a sale representing the seller and you don't have as much of an impact from the homebuyer taking longer to find a house or close on a house? So I'm just trying to understand the dynamics of the growing seller mix and how that impacts the gross margin.

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

Well, we make more money from buyers even though it's harder to buy a house than it is to sell one. And that's just because our fees are higher when we represent a buyer than when we represent a seller. We keep more of the commission in that situation. So what you're seeing as we have more and more listings as a percentage of our overall sales is that we have to keep more of the commission that is given to us, rather than refunding such a large portion to the buyer. And that's how we keep revenue per transaction between buyers and sellers basically flat year-to-year. And what happened last year is we got a little bit behind that because listings grew a little faster than we expected. And now what we're doing is trying to price just a little bit ahead of that, but the goal is to keep revenue per transaction flat. And trying to answer your question, just remember, we make more money from buyers than sellers. So as the mix shifts toward sellers, we have to charge buyers just a little bit more to pay for that.

Operator

We'll now take our next question from Stephen Sheldon with William Blair.

Stephen Hardy Sheldon - *William Blair & Company L.L.C., Research Division - Analyst*

Just want to get an update on trends over the last few quarters in the markets where you have 1% commission rate. I get the environment is a little more challenged lately, but have you seen any notable increase in market share over the last few quarters in those markets? Or is it still too early, I guess, to see that impact?

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

I would say that it's early in those markets to declare victory, but it was a well-established finding before we launched in those markets that the overall impact on share among buyers and sellers accelerates modestly when we shift pricing toward the seller to benefit the seller. And that's, as we said, because the seller is so much more price-sensitive. She signs a contract before listing her house. She agrees to a price before listing her house when she chooses an agent. And so in Denver and San Diego and Seattle and places like that, we had run 1% pricing for years. And we carefully studied whether that hurt our share among buyers, whether it helped our share among sellers. And what we determined was that, overall, it had a positive effect. And it's possible, of course, that as the market shifts, which inevitably it will, toward buyers, that we want to recalibrate that pricing to benefit the buyer more. But right now, everybody in real estate wants to represent sellers, and our pricing really favors that.

Operator

We'll now take our next question from Tom Champion with Cowen.

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

Apologies if I missed it, but can you talk about your thoughts around gross margin expectations for full year '18? I think there was some commentary about it on the last call. And then just a quick one. Can you let us know your total markets? I think it's mid to high 80s. But just curious where you are now and maybe how that should trend going forward.

Chris Nielsen - *Redfin Corporation - CFO and Principal Financial & Accounting Officer*

Sure. So this is Chris. We haven't set any specific expectations for gross margin in 2018. The commentary on the last call and a little bit on this call is a point that we're making -- that we are hiring more agents to help even more customers more deeply on the buy side, help them sort through low inventory situations, low inventory conditions, to find the right home for them. And so -- on a relative basis, that means that gross margin will hold down because we'll spend some more on agent compensation to help out customers more than we otherwise would. So just directionally, that's the feedback that we provided. In terms of markets, we are in 86 markets across the U.S. at this point.

Operator

We'll now take our next question from John Egbert with Stifel.

John Peter Egbert - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

I was wondering how longtime Redfin agents are responding to plans to lower the number of customers they'll be working with. Are they worried this could hurt their individual earnings potential? Or do they buy in to the rationale that this could benefit closing rates across the company? And also, how do you think traditional brokerages are trying to navigate these same headwinds of the housing inventory crunch? Are they employing different strategies or trying some of the same things?

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

So the strategy to reduce the number of customers each agent supports was met with widespread enthusiasm at our annual kickoff, which we held on January 12, even among the most well-tenured agents. And I think it would be different if we were taking them to a level of customers that was radically lower than what they'd experienced in the past. This is higher than what they had in 2016, just lower than 2017. And I think everyone just felt that this is exactly the service we want to provide and that we'll actually do better by our customers given the difficulty of the housing environment. So I would say that I've rolled out, Chris has rolled out, Scott, our president of real estate operations, has rolled out all sorts of initiatives that have been met with mixed responses at kickoffs. This was one that was universally or near universally embraced. People love it. Was there a second part to that question? Or was that it?

John Peter Egbert - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

There was a -- how you think traditional brokerages that you compete with are trying to navigate those same headwinds? Are they employing similar strategies or different strategies?

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

You'd have to ask them. I'm not trying to be flip or coy. I just -- I know that when people try to speculate on what Redfin was thinking, I wonder why don't they just ask us? And in this case I think the most respectful thing to do would be to ask them.

Operator

(Operator Instructions) We'll now take our next question from Brad Erickson with KeyBanc.

Elliot Jacob Arnson - *KeyBanc Capital Markets Inc., Research Division - Associate*

This is Elliot Arnson on for Brad. Just real quick going back to the deceleration implied for Q1, can you just comment a little bit about the pace of agent hiring or lead volume growth?

Chris Nielsen - *Redfin Corporation - CFO and Principal Financial & Accounting Officer*

Sure. So we're not giving specific guidance for Q1 agent hiring, but you can see that both in the third quarter and the fourth quarter, we did continue to step up our hiring of lead agents. And that's in anticipation of being able to help even more customers more deeply through the first part of this year and really have those customers in a good position then to get them all the way through the close of transactions in the second and third quarters. So we're not providing any more detailed guidance on our expectations there.

Operator

(Operator Instructions) It appears there are no further questions at this time. Ms. Elena Perron, I'd like to turn the conference back to you for any additional or closing remarks.

Elena Perron - *Redfin Corporation - Head of Investor Relations*

Thank you, Cassy, and thanks, everyone, for joining us today. We appreciate your interest in Redfin and look forward to speaking with you again next quarter.

Operator

That concludes today's presentation. Thank you for your participation. You may now disconnect.
