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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to today's Redfin Corporation First Quarter 2018 Earnings Call. As a reminder, today's call is being recorded.

And at this time, I'd like to turn the floor over to Elena Perron.

Elena Perron *- Redfin Corporation - Head of IR*

Thank you, Greg. Good afternoon, and welcome to Redfin's financial results conference call for the first quarter ended March 31, 2018. 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, know 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 gained significant market share in the first quarter, and our revenues exceeded the range we gave you in February. Major initiatives to advertise via new media and deliver more personal service to our agents showed promise, and our mortgage and Redfin Now businesses accelerated.

Our first quarter revenue was $79.9 million, an increase of 33% over the first quarter of 2017. Excluding new businesses, sales through our own agents and our partner agents were up 28% over the first quarter of 2017. We lost $36.4 million in the first quarter at the favorable end of the range we discussed on our last call. Our profits are always worst in the first quarter as we hire agents, run ads and host home tours to set up sales in the second and third quarter.

We continue to focus on share as the best measure of our market power and growth, and we've once again been pleased by our share gains in the opening 3 months of 2018. We grew share by 0.15 percentage points year-over-year. This matches our year-over-year share gain in the fourth quarter of 2017, which was an acceleration from the 3 prior quarters in 2017.

And what makes these gains and share durable is our customer loyalty. One gauge of this loyalty is how many people use the same brokerage to sell the home that they originally bought via that brokerage. For homes sold in the first quarter of this year, Redfin's loyalty was 56% higher than traditional brokers. In the first quarter of 2017, our advantage in customer loyalty was 43%. Our low fees are likely one reason for this loyalty. Compared to the typical commission charged by traditional agents, we saved our first quarter customers over $23 million in fees.

We continue to see strong traffic growth, though at more modest levels than in 2017. From the first quarter of 2017 to the first quarter of 2018, visitors to our website and mobile applications increased by 28% compared to 33% year-over-year growth in the fourth quarter of 2017. Year-over-year gains in traffic growth could moderate further in the second quarter as we're now comparing ourselves to a time last year when traffic was spiking. But absolute traffic will remain high for 2018, and we expect to keep growing our traffic faster than other major sites.

We have plenty of other ways to grow. We'll continue to supplement our traffic-driven growth by getting more site visitors to try a Redfin agent and then by working to increase the rate at which those customers close a sale with an agent. We'll offer mortgage and title services to those customers and seek to develop new, unique brokerage offerings to draw more customers to Redfin.

But our growth also depends on higher consumer awareness about our service. We're advertising more. With first quarter spending rising to $11.3 million, a 39% increase over the first quarter of 2017. Beyond the spending increase, this year's campaign has differed from previous campaigns in 2 other respects: we're promoting our 1% fee for listing a home in mass media ads; and the media we're using now include radio and billboards, not just television and digital video. Until now, we've been bashful about promoting our price because of concerns the consumers would associate lower prices with less service. What we're most proud of are the results we deliver for customers, that Redfin's full-service agents sell homes for more money, faster, with higher customer satisfaction, not just our fee.

But prospective customers respond to low prices. The markets with ads promoting the 1% price gained listing share 2 to 3 times faster than similar markets that didn't run the ad. These gains in listing share reinforce our ads with Redfin signs in front of the homes we're hired to sell. We don't know yet if these ads will be profitable. It has been encouraging that, when we compare the first quarter of 2018 to the same quarter last year, the cost of meeting a new customer via mass media ads declined by 25%. But we can't declare victory yet because the profit of mass media ads depends on increased sales for a full year after the ads run.

From airing TV ads since 2014 in 14 markets, we have learned that a market's sales can be meaningfully higher 18 or even 24 months after a TV campaign ends. But we don't know if radio and billboard ads are as memorable as TV ads and can't say if their sales contributions will be as lasting. Our goal is to develop mass media channels that make money as reliably as our Google ads. But advertising to customers who only buy a home once every 12 years and then only after months of consideration, is a long-term, risky bet. What makes it even riskier is that a customer's profitability varies by thousands, depending on whether she's buying a mansion or a fixer-upper. The complexity, risk and time required to make advertising work are exactly why we believe we can develop advertising as a competitive weapon. We know more than virtually any other brokerage about which of our customers close. We're willing to wait longer for it to happen, and we're constantly seeking to optimize every step in between. Most important, we have a consistent service delivered at a consistent price, which gives us a brand to build on in our ads. But despite encouraging progress this quarter, we still have plenty to learn.

Our investments in driving demand depend, in turn, on how well we serve our customers. We can afford to advertise more when more of the customers who respond to an end up buying or selling a home via Redfin. As we discussed in our last earnings call, Redfin is lowering the average number of homebuying customers a Redfin agent serves in 2018 by 10% from 2017. Our goal is to increase the rate at which those customers succeed in buying a home. Because it has gotten so hard to buy a home in almost every major U.S. market, the most powerful lever for increasing the profitability of our field organization and of Redfin overall is making more of our homebuying customers successful. The most successful real estate brokerage in America will be the one with the customers who are most successful.

As we said on our last earnings call, we won't be able to tell until June at the earliest whether reducing the customers supported by each agent will lead to more customer success. This wait is largely because we hired a large number of agents coming into 2018, so we couldn't meaningfully limit how many customers each agent supports until April, the time each year when homebuyers start to sign up in droves for home tours and agent meetings.

Coming into 2018, we also expected it to take months for more than 1,000 agents, coordinators and managers to execute a change that involves more time for meeting customers over the weekends, new tactics to ask customers for face-to-face strategy sessions and new performance metrics. For these reasons, we were clear on our last earnings call that no one should expect meaningful results from this initiative in the first quarter of 2018. The number of customers assigned to each agent in the first quarter never reached the limits we put in place for later in the year. Because it was early in the season, we weren't concerned that a Redfin agent served slightly more customers on average than she did in the first 3 months of 2017. But still, it made us nervous that as the housing market became even more competitive than last year, a Redfin agent's customers were slightly less likely to remain engaged with that agent in the homebuying process than in the first quarter of 2017.

Now we've begun to see a change. As demand increased in April 2018, we started to send more customers to our partners than we would have in years past and fewer to our own agents. As expected, the customers we kept have been more likely to engage their Redfin agent a second time, whether that's to tour more homes or to talk at a coffee shop about how to win in this market. This uptick in customer engagement often leads to a higher customer success rate. But the uptick was small and only occurred over the last few weeks, so it could easily regress to the mean or even reverse. We expect progress on this initiative to be saw-toothed and slow, but we still expect progress.

On our second quarter earnings call, we'll report on whether this increased customer engagement continues and if it leads to more sales, but that will still only be a few months of data. We won't have a clear view on the strategy's 2018 impact until our third quarter earnings call, and it will take years to understand fully how much we can improve customer success rate through service improvements. We continue to believe this improvement can be significant.

But Redfin's growth doesn't just depend on more sales through our standard brokerage service. We've invested in 2 experimental services for would-be home sellers: Redfin Concierge Service and Redfin Now. We've also made a long-term commitment to Redfin Mortgage. We're pleased with the progress of all 3 offerings, including our premium service for staging our customers listings, Redfin Concierge. We don't have time to discuss Concierge today, but we'll update you on it as we learn more about customers' willingness to pay its 2% fee and whether that results in a higher price paid for the home.

Redfin Now is a larger initiative. Now is our program to buy an owner's home outright, letting her move on with cash in her pocket while we try to spruce up the home and then sell it for 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. We began buying homes through Redfin Now in January 2017 and closed our first sale in April 2017. We've limited ourselves to affordable parts of Southern California and initially, the $10 million in home purchases at any one time. In last quarter's call, we discussed plans to increase Redfin Now's capital limit to $20 million. But based on our continued success selling the homes we bought and the growing demand for us to buy more, we're now raising that second quarter limit to $25 million.

Redfin Now purchases dropped in the fourth quarter when we offered homeowners less money for their homes, but then rebounded this past quarter when we offered more. With this more aggressive approach, we expect Redfin Now to keep growing, from more than 15 purchases in the first quarter of 2018 to more than 30 in the second quarter. The main risk is that we overpay for homes that we later have to sell at a loss. Redfin Now may have some homes every quarter to sell for a loss, but we expect the vast majority of sales to be for a gain that outweighs those losses. Of the homes we bought in the fourth quarter of 2017, only 2 remained unsold. We expect to sell both in June.

Redfin Mortgage, our other capital-intensive growth initiative, is also going well. Already, we made about 20 loans in the fourth quarter of 2017 and nearly 40 in the first quarter of 2018, with similar growth expected for the second quarter. We launched Redfin Mortgage in the first quarter of 2017 to issue loans to our homebuying customers in Texas. Our premise has been that integrating a lending operation with Redfin's brokerage and title businesses all running off our own software can ultimately lead to an entirely digital closing where Redfin borrowers compete like cash buyers. We expanded to Illinois and Washington, D.C. in the fourth quarter and then to Pennsylvania, Virginia and Minnesota in the first 3 months of 2018. Our customers have been very happy with the service, and we expect more Redfin agents to recommend a Redfin Mortgage as a result, with revenues increasing in each market and the number of markets we serve expanding at the same time.

Expanding our mortgage service to new markets has been much easier than expanding our brokerage because the underwriting guidelines for originating a mortgage don't vary from state to state. We're also developing our own software to support this business, which will take tens of millions of dollars over many years, but the result should eventually be lower cost than many of our competitors and better service.

No matter what we do to deliver more value to our customers, the fundamental problem is that there aren't enough homes to buy. Over the past two years, the number of new homes built per capita was 25% below the 50-year average. Since 2016, the average number of homes for sale per capita is 33% below historical averages. Inventory has declined year-over-year for 34 consecutive months, with scant signs of relief in sight. The number of listings on April 30, 2018, was 8 -- excuse me, 8.4% lower than it was a year prior. And since 2010, the number of residents per home for sale in coastal markets like San Jose, Seattle and Boston has tripled. And in once-affordable cities like Denver and Portland, it has doubled. In Seattle, Redfin alone had almost as many homebuying customers for the month of April as there were homes for sale on any given day. And Redfin has less than 5% share here.

And it's not just Seattle. Of the 86 markets in which we employ agents, the only Redfin market where we have not had reports of frequent bidding wars this year is Oklahoma City, which has been hurt by low oil prices. The national market has thus become simple to understand, regardless of interest rate increases, stock market volatility, wage growth and consumer confidence. We now view U.S. home sales volume almost purely as a function of inventory. So unless significantly more listings reach the market, we expect U.S. total home sales to be flat at best in 2018.

And this inventory crunch is only going to get worse. As the economy roars, only 900,000 new single-family homes are expected to be started this year, 39% below per capita historical averages. Even when 1 homeowner moves up, another homeowner doesn't move in. A renter often does instead. Credit has become cheap but is limited to only half of America, making us a landlord nation with 1/2 of Americans renting out homes to the other half. The proportion of owner-occupied single-family homes is down 4.5% since 2000. This is why, since 2012, home prices have increased 43% faster than inflation overall. It's why in an era of affluence for virtually every major American city, many people feel that they can't afford to live in their city. Normally, higher prices would induce more construction, but zoning laws make that hard. These laws, supported on the left and right, are fiercely defended by well-meaning neighborhood associations that have sometimes started to act as a cartel to limit housing supply and keep home prices high. And it's these laws, not market forces, that prevent builders from replacing parking lots, strip malls and single-family homes with affordable high-density condos and townhouses. Since 2008, government at every level has receded from its commitment to the American dream, despite ample evidence that owning your home leads to more stable families and careers and deeper community and civic involvement. The private sector can't solve this problem on its own. Eventually, the government will, as we restore a consensus that affordable housing is a public good.

For now, Redfin and everyone else in the industry will do just fine with the market we have, but we'd be remiss in our accounting of this business if we didn't also account for the frustration felt by the people we serve and what we, as a society, could do to solve their problem unavoidably, indisputably, enthusiastically by building more homes.

With that, I'll turn it over to Chris.

Chris Nielsen - *Redfin Corporation - CFO*

Thanks, Glenn. We're off the solid start in 2018 with $80 million in first quarter revenue, coming in a bit better than we expected. Revenue includes the $3 million contribution from Redfin Now and was up 33% from last year. Real estate revenue, which excludes Redfin Now, Mortgage and other services, grew 28% year-over-year. Brokerage revenue or revenue from home sales closed by our own agents was up 29% from 28% growth in brokerage transactions. Revenue per brokerage transaction grew 1% as we continue to reduce refunds to homebuyers, slightly ahead of the ongoing mix shift to our listings business. Revenue from our partner agents grew 23% on 10% growth in partner transactions. Revenue per partner transaction increased 12% as we discontinued issuing a $500 refund to partner program customers at the end of 2017.

Other segment revenue of $5.0 million was up from $1.5 million in the first quarter of 2017. This revenue includes Redfin Now home sales as well as revenue from title services, mortgage originations and other services. We had no revenue from Redfin Now in the first quarter of 2017.

Gross profit was $5.7 million, down 11% 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 down 340 basis points year-over-year. This was driven by a 190 basis point increase in personnel expenses, including stock-based compensation, and 90 basis point increase in transaction bonuses and a 60 basis point increase in field operating expenses.

As we discussed on previous earnings calls, we have been investing and hiring more lead agents to increase our service levels and improve close rates, particularly for homebuying customers. The increase in our headcount-related field expenses reflects that strategy.

We expect real estate gross margin to be down year-over-year during the second quarter of 2018, although perhaps not as much as during the first quarter. We've hired more agents to reduce the average number of homebuying customers an agent served in 2018, and the resulting additional cost weighs on gross margin. As Glenn talked about earlier, if we are able to improve customers' success rates, gross margin may even be a touch closer to 2017 levels in the second half of the year.

We continue to invest in the businesses accounted for in our other segment, including Redfin Now, mortgage and title services. Combined, these businesses lost $1.1 million in gross profit compared to the gross profit loss of $840,000 in the first quarter of 2017.

Operating expenses showed continued leverage, growing 24% year-over-year and representing 54% of revenue, down from 58% in the first quarter of 2017. This is consistent with our operating model of growing fixed costs slower than revenue.

Note that our stock-based compensation increased 57% year-over-year to 5.3% of revenue, up from 4.5% of revenue in the first quarter of 2017. We have rolled out new stock compensation plans for employees, and we expect stock-based compensation expense to go up slightly as a percentage of revenue going forward relative to historical levels.

Our net loss, including stock-based compensation and depreciation, was $36.4 million compared to a $28.1 million net loss in the first quarter of 2017. Diluted net loss per common share was $0.44 for the first quarter of 2018 compared with a $3.58 diluted net loss per common share in the first quarter of 2017. 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 first quarter of 2017 was $0.40. Adjusted diluted net loss per common share includes stock-based compensation.

Now turning to our financial expectations for the second quarter of 2018. Revenue is expected to be between $134.8 million and $139.1 million, representing year-over-year growth between 29% and 33%. We expect Redfin Now to account for $5.2 million to $6.2 million of that revenue.

Net income is expected to be between $1.0 million loss and $1.5 million profit compared with a $4.3 million profit in the second quarter of 2017. This guidance includes approximately $4.8 million of stock-based compensation and $2.0 million of depreciation and amortization. It assumes, among other things, that no additional business acquisitions, investments, restructurings or other 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) And first from RBC Capital Markets, we have Mark Mahaney.

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

Okay. 2 questions, please. Glenn, I get your point -- your points at the very end of your prepared remarks. If you look into your real estate crystal ball, do you think that there is a reason why we'll see kind of a breakthrough or a breaking down or whatever it is of the logjam, and we actually would see more homes being developed? Is there a backdrop that makes you maybe a little bit optimistic on that? And then secondly, this Redfin Now, there's obviously -- looking at what Zillow did, there's obviously seems to be much greater industry interest in this concept. And I forget what we're calling this, iBuying or [homeflipping.com], or whatever it is, but it seems like there's a lot of momentum in the space. When you think about it, like what percentage of homes, like big picture, do you think could actually be bought and sold this way? It sounds like you're getting more committed to this kind of as a venture. Just overall thoughts about how big you think this could be long term.

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

So the answer to the first question is no. I don't see any reason to believe that there will be more inventory in the next 6 to 12 months. And beyond that, it's pure speculation. As far as the percentage of sales in the United States that could be bought by an institution, handled by institution, I think it's less than 10%. So very expensive homes. Customers are not going to be as interested in this just because the dollars, the absolute dollars that they give up when an institution buys the home will make it less appealing. And then when you look at other types of customers where they're selling more fungible homes at more modest price points, then you're going to see somewhere between 10% and 20%, but it's really a function of economics. So if we can lower the cost of an institutional sale to the point where it's competitive with the cost of an agency sale where you're hiring a real estate agent to sell the house and you own it until then, then I think you're going to see a massive volume shift toward an institutional purchase. But neither one of those numbers is going to remain constant. So Redfin, Opendoor, Zillow and others are, obviously, going to try to lower the cost of an institutional sale significantly below 10%, but the cost of an agency sale isn't just going to be 5% or 6%. And we have seen almost every single potential customer evaluate this cost. If it's a very, very small gap, they'll take the cash on the barrel. But as that gap widens and they can make more money because a real estate agent says, "We can sell this house. It won't cost you much. It won't take long. And there's not much risk." Then they decide to wait and put more money in their pocket through an agency sale. So the macroeconomic factors that can change are just -- it could become a buyer's market instead of a seller's market, and the cost of capital could increase. Obviously, almost everyone doing this is doing it on leverage. Even at the start, you do it off your own balance sheet.

Operator

Moving on, from D.A. Davidson, we have Tom White.

Thomas Cauthorn White - *D.A. Davidson & Co., Research Division - Research Analyst*

On lead agent growth, it seems like you guys had a pretty good quarter hiring there. Can you maybe update us on sort of what you guys are thinking in sort of the ideal background that you're looking for and kind of what the market for that type of talent is? And were you able to hire as many lead agents as you'd hoped? And then just on kind of the iBuyer space or Redfin Now, could you remind me how you guys are selling those homes? Do you just list them on the MLS with one of your own brokers? Or is there another way that you're looking to resell those? And then just sort of high level, what are the advantages that you guys think you bring to that space relative to some of the data or scale advantages that some of the other players that have entered might offer?

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

Try to answer those as quickly as we can. Historically, half of our agents have come from other brokerages, and half have been trained from outside the industry. But that's shifting. Many people ask us what's different after we've gone public, and almost nothing is, except that more traditional real estate agents are applying to work here, and it's actually made it easier to hire. I think there's a growing realization that different kinds of real estate brokerages are going to prosper in the United States. So we have been hiring more people probably from the industry. And obviously, we study what kind of background is correlated with high customer satisfaction, high productivity, low attrition. To answer your second question about the iBuyer program, we believe that we have a competitive advantage here because of our history selling houses. We've been doing it for 14 years. So no one really has that operational expertise, coupled with the online reach. There are institutional buyers that really understand the business of selling houses and owning property. There are websites that have the online reach, but we have both. And so we're fairly confident that we can have a cost advantage here because of that pairing. And of course, we use our own agents to sell the house. That's something that we've been doing for a long time. It gives us a better eye for the kinds of properties that are going to be marketed quickly and sold reliably.

Operator

Moving on, we have Jason Helfstein with Oppenheimer.

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

Just -- there was obviously a different pattern between partner transaction and yours. Did that just happen to work out that way? Or are you choosing to ship more houses to your platform? Secondarily, what -- it sounds like there's a big opportunity here to mine the customers that come through your funnel, consumers who end up renting. I mean, I've asked this in the past. But any thoughts about how to monetize those consumers who don't end up buying a home and become renters and how you've been participating with that?

Chris Nielsen - *Redfin Corporation - CFO*

Yes. So in the first quarter, we did have a little bit more volume going to our brokerage agents as a percentage of total transaction. The reason for that is that we had staffed up to have the right number of agents in place to be able to really serve those customers. And so that's a by-product of what Glenn talked about in terms of accelerating our hiring to be able to serve, in particular, homebuying customers a little bit more fully. Glenn also talked about that as we get into the heart of the selling season and our agents get busy, we are more willing than in past years to introduce those customers -- some customers to partner agents to ensure that our own brokerage agents don't get too busy. And so that's part of the dynamic that you should expect related to partner versus brokerage transactions. Do you want to talk about rentals, Glenn?

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

We need to make money someday off that business, but there are so many other ways to grow right now that are higher priority. Had we world enough and time.

Operator

All right. And our next question will be from Stephen Sheldon with William Blair.

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

Wanted to ask about your listings share specifically in your top 10 markets. It sounds like you saw much stronger gains in markets where you advertised the 1% commission heavily. But I guess, first, are you pushing some agents to now focus more on seller representation than they have in the past? And then second, any color on the visibility you may have into the listing pipeline kind of heading into the key season here?

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

The listing business has outperformed our expectations in markets where we advertise and in markets where we don't. This is a product that sells itself, and advertising has only accelerated that. The staffing is really driven by the demand, so it's not as if we drive demand by hiring real estate agents. We drive demand by offering a better product and getting more traffic on our site to connect with our agents. So we will shift agents from one product to the other based on that demand. But overall, we've been very encouraged by listing share gain. Going into the second quarter, we just expect more of the same. We're not segmenting revenues in our guidance or in our reporting. But this product is doing well, and we're happy it is.

Operator

Next, from Goldman Sachs, we have Heath Terry.

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

Wondering if you could give us a sense sort of what you're seeing in your cost of traffic acquisition by channel to the extent that you're seeing the house price inflation that you are across as many markets as you are. Wondering how that's showing up in the channels that you use to acquire customers. And then on the Redfin Now product, obviously, there are a lot of entrants sort of into this space, into this model. What keeps you from pushing that even faster? Why an incremental $5 million and not an incremental $50 million?

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

All fair questions. So we focus on acquiring customers instead of traffic, and the real lever for that isn't just home prices, although that's the right question to ask. It's the rate at which we can convert someone who comes to our site after clicking on an ad to contact an agent. As we improve those conversion rates, we can invest more aggressively in advertising. Having more expensive homes compounds that effect, and it's only offset by rising media rates. So you're going to see Facebook and Google looking at the opportunity the same way we do and taking the measure of our profit on a transaction and making it theirs. So we just have to get that much more efficient every quarter. And where we really compare ourselves to is the rest of the industry. If we're just much better at getting someone to land on a web page to describe the house and then clicking a button to see an agent and then also have superior close rates, that just translates into more money that we can spend as opposed to anyone else on meeting that customer in the first place. So I think we're encouraged by the fact that we're getting more efficient throughout the funnel, and that lets us pour more demand into the top of the funnel. But it's not a step function. It's a game of inches, every quarter, every week, every day, trying to drive conversion. And on the iBuyer program, I know everyone's excited because Zillow got into it over the past few weeks or months. I am excited about it, too, but that is a capital-intensive business. The largest segment of the market is going to be listing homes through an agent. And the way to take the most listing share is to lower the cost of selling homes through an agent and put more money in the pockets of our customers. There is going to be a turn in the market where the cost of capital is higher, the holding period is longer, it's harder to find a buyer. And no one, whether it's Opendoor, Redfin, Zillow or anyone else knows what will happen to this business when that happens. And the fact that capital is so cheap right now has brought plenty of us into this business. But we're just cognizant of what happens on the other side of that because we've been on the other side of other downturns. I think the words we used on the road show were that we were born in the dark. So that day is coming again, and we just don't know what the mix shift between merchant and agency sales will be in a down market.

Operator

Next, we have Jason Deleeuw with Piper Jaffray.

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

I'm just trying to get a sense on thinking for the guidance, taking it from the revenue down to the net income. And it sounds like the gross margin maybe not quite as bad as the first quarter, I believe, is what was said. But then, how should we think about some of the OpEx, like the marketing spend? Is that going to step up again in the second quarter?

Chris Nielsen - *Redfin Corporation - CFO*

Yes. So we're not providing OpEx guidance specifically. As Glenn talked about in his remarks, we are continuing to advertise as we go into the second quarter of the year, but we're not breaking out any more detail on those operating expenses. So you should, as I noted in my remarks, expect that we continue to have gross margin pressure as we've hired agents to serve customers, we think, in the right way, more fully during this time when inventory is high.

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

Okay. And then maybe I missed this, but what's the percentage of transaction seller versus buy side right now? And then agent productivity, selling versus buying, any color on that?

Chris Nielsen - *Redfin Corporation - CFO*

Yes. So on a quarterly basis, we don't break out the sell side versus the buy side of transactions. With regard to productivity, really, there are puts and takes there, market by market, agent by agent. That's also not something that we provided more detail on. It is the case in today's market, our sell-side agents are very productive in that when a home goes on the market, they are often able to get all the way through to a close transaction. And our buy-side agents face this real challenge working with customers where buy-side customers do want homes, they want to find the right home for them, but with tight inventory, everyone just has to work really hard to find that right home and get a winning offer. And so those are the kind of pieces that go into agent productivity right now.

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

And just to add color to that, what we're trying to do is take the gain on listing agent productivity but then figure out how to crack the code on buyer agent productivity. Now if both of them could be that productive in a strong seller's market, that's the dream. But we're working more on the buy side because that's where it's so hard.

Operator

Next, we have Brent Thill from Jefferies.

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

Glenn, many of us in the San Francisco Bay Area are seeing more Redfin sell signs on more expensive homes in excess of $1 million. And are you starting to see a shift upstream from where you were a year ago?

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

I don't have the data on that, so I don't want to speak anecdotally, and yet I will. I see the same damn thing. I mean, we just did a $7 million humdinger up here in Seattle, and I could not be more excited about it. I think it gives permission to all sorts of people who are risk-averse to sell their home because if somebody did a $7 million, a $10 million house with a Redfin sign, well, why not sell my $2 million house? So I know all of you guys are loaded. When you guys sell your house, sell it through us.

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

That's Mark Mahaney, not the rest of us.

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

By the way, we were debating if there had been a 14-second Elon Musk-style pause in between questions. How much fun would that be for everyone?

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

Real quick, Chris, just on the internal agent hiring. Are you still as aggressive going into Q2 as you were in the back half of '17? Or are you laying off a little bit here?

Chris Nielsen - *Redfin Corporation - CFO*

Yes. So our hiring is really focused on the peak of the season, which happens between the second and the third quarters. And so really, as we get towards the end of the second quarter, we begin to slow down a little bit and then really reload as we get into the fourth quarter of every year. So Glenn talked about it. We did start hiring earlier this year relative to last year, and we'll try and match our peak staffing with the peak demand.

Operator

And next, we have Tom Champion from Cowen.

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

So it sounds like the market share gains have been driven by the 1% commission, and I'm just curious if you're seeing competitors match your offering and responding. And you guys have been marketing aggressively, and you've got a lot more agents. Any reason to think that the year-over-year share gain would slow? It seems like it could be the new normal. And then just a quick question on Redfin Now. I'm just curious why this option makes sense for home sellers in this ultra-competitive supply-constrained market. Any thoughts on that would be really helpful.

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

Sure. So why don't we talk about Redfin Now first? There are people who just want to be done with it. There are investors who live in another city. But part of this is a credit arbitrage opportunity that they can't get the loan to buy the next house because they still own the last house. And even though there are fairly strict lending guidelines for consumers, there are not for companies. So if you have this asymmetry in the market where companies can get easy access to capital but consumers can't, we become the provider of liquidity. And that is one of the services that we offer. 10 years ago, when there was a hot market, people would just get a loan for their next house while they still own the last house. But that's just harder to do now. And then what was the other question?

Elena Perron - *Redfin Corporation - Head of IR*

Market share gains.

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

Oh, are they durable? I don't want to say that 0.15% is the new normal. But in general, I feel confident about our competitive position that we will take share year-over-year going forward as best as we can judge. There are new competitors in the space. More than $1 billion of private capital is flowing into real estate companies, and it used to be that those were media companies, and now almost all of them are transactional companies. And most of them have as their first slide some story on how they're going to beat us. And when I see that, I say, "Bring it on." Really smart guys doing really cool things, but we've been braced for competition for a long time. So hopefully, we can meet the challenge. And I said, "Bring it on" in a loving, giving, joking way. I didn't want to goad anyone.

Operator

Next, from Bank of America Merrill Lynch, we have Nat Schindler.

Nathaniel Holmes Schindler - *BofA Merrill Lynch, Research Division - Director*

Just a question. On Redfin Now, how many homes do you -- do people start the process with you and then don't go through, whether or not it's you decide not to buy the house or they don't decide to buy that -- sell to you?

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

Most of the prospective customers don't actually sell their house to Redfin Now, and the insight here is just that if I could tell you before you're selling your house that we could put together a cash offer, do you want to see it? You would say yes. But whether you took the offer would be another question entirely. And so I think Zillow has talked about this. It's something that we've noticed, too. That this iBuyer type of program might be more of a website feature than it is a retail operation, that many people want to see the offer even if most people don't want to take the offer.

Nathaniel Holmes Schindler - *BofA Merrill Lynch, Research Division - Director*

And just to follow up, so is that roughly 10:1? Or is it the different ratio than that? And then additionally, are you able to turn any of those, basically, people that you -- come to you and you go through the process with on Redfin Now into sell-side engagements?

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

Yes. So I think that's the only responsible way or one of the only responsible ways to offer this product, at least for us. It was uncomfortable for me at first to be on the other side of the table from a customer because that's what we're doing when we're buying their house. We're saying, "We're a counterparty. We want to buy this house for $400,000." And the responsible thing that we have to do is also have a real estate agent say, "Don't take that offer. We could sell it for $430,000 in 2 weeks flat." And there are going to be some people who take $430,000. And there are going to be some people who take the money now. But we just want customers to have both choices. And it is the size of that gap that determines the proportion of people who choose one over the other. I know you want to know whether it's 1 out of 10 or 2 out of 10 or 1 out of 20. And we're not sharing that because we feel careful and competitive about it, but also because it changes based on how much risk we want to take. As we move our margin down, we obviously lower our margin of error and we drive more volume to the iBuyer side of the house.

Nathaniel Holmes Schindler - *BofA Merrill Lynch, Research Division - Director*

Okay. And then just one final follow-up on this. How much roughly are you spending per home, whether in a percentage or in a -- in dollars or whatever, on the -- on staging it -- to flip it?

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

It just varies by house. So if you think the house needs a lot of work, you're going to price that into the offer you make to the owner. And they may say 6 months later, "Look at that markup." But they don't know that we roughed in a new bedroom. In general, we do not want to be in the general contractor business where we are doing an enormous amount of work to every single house. It's hard enough just to keep the lawn cut. So we're into operationally intensive businesses, but we're not running one of those home-flipping shows where they remodel the whole freaking thing. It's too much.

Nathaniel Holmes Schindler - *BofA Merrill Lynch, Research Division - Director*

Was doing any real remodel scale? I mean, it's all unique to every house, right?

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

I found that when you can do something really nasty and weird and complicated at scale, you have a deep competitive advantage. So as I said, we're not taking the homes down to the studs, but we are good at doing things like getting the lawn cut, painting a yard sign, paint and carpet for a large number of homes in a large number of geographies. That's also the underpinning of this Redfin Concierge Service where we use the economic advantage we have around being able to meet customers at a lower cost and sell homes faster to offer a service that no one else can. As part of just our standard service, I think we're one of the only brokerages that says, "For 2%, we'll paint it and fix it up." And taking that on isn't for the faint of heart, but we feel like we've taken on other nasty things like that before, so let's dive in.

Operator

(Operator Instructions) Next, we'll move to John Campbell with Stephens.

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

I'm jumping on a little late, so I apologize if I missed this already or if you guys covered this. But can you guys talk a little bit to the buy-side rebate? And how much you're retaining now versus last year? And if that's -- how that's influencing the average revenue per transaction?

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

So the refund is coming down, and the main reason that's happening is because we try to keep revenue per transaction constant year-over-year. So what's happening is that we have more sellers in the mix. It used to be that a huge proportion of our customers were buyers because we started by building a website for buyers. We invented map-based search, and home buyers beat a path to our door. But now as we've developed a more competitive listing product and especially now that we've got a 1% fee and 5 years of data showing that we sell homes for more money faster, the listing product is really taking off. And every time that mix shifts more towards the listing product, to keep revenue per transaction flat, we have to reduce the amount of savings for the buyer. And the idea here is that we want to save people the same amount of money, but when more of them are sellers, more of the sellers get the savings. So it'll come down a little bit, but not a lot. And it's all driven by the mix shift.

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

And then on -- I guess, on the buyer demand, you're not really seeing any kind of impact there as you bring that rebate further down.

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

I feel careful about it. We could see that, but mostly, we haven't. I think the issue for buyers right now is the inventory. I tried to say this in the script when we were talking about inventory. It's a cri de coeur. When you go to a homebuying class, just on your way out of the office to grab a bag of nuts or something and there's a class in the background, you just see angry, scared faces. And it has nothing to do with the Redfin agent. It's just how hard it is. The people who are buying homes right now are really mad. They're mad about the market. They're mad about feeling poor when the economy is doing so well. That's the challenge representing our homebuyers is dealing with that emotion and trying to figure out ways to make them more competitive.

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

Okay. And then last one for me. On the April market trends, can you guys talk just kind of broadly to some of the bigger markets, Seattle, D.C., Chicago? And just how transactions maybe looked a little bit in April?

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

We don't do segmentation by month by market.

Chris Nielsen - *Redfin Corporation - CFO*

Yes, that's -- it's the detail that we haven't broken out. I do think that the overall challenge we're seeing in markets is related to inventory. And that's true in most places in the U.S. but certainly true in major urban centers.

Operator

Ladies and gentlemen, that does conclude today's question-and-answer session. I'd like to turn the floor back to Ms. Perron for any additional or closing remarks.

Elena Perron - *Redfin Corporation - Head of IR*

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

Operator

Ladies and gentlemen, that does conclude today's call. Once again, thank you for joining us. You may now disconnect.

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