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RDFN.OQ - Q3 2017 Redfin Corp Earnings Call

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NOVEMBER 09, 2017 / 9:30PM, RDFN.OQ - Q3 2017 Redfin Corp Earnings Call

## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

**Brandon Burke Dobell** *William Blair & Company L.L.C., Research Division - Partner & Group Head of Global Services*

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

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

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

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

## PRESENTATION

### Operator

Good day, everyone, and welcome to the Redfin Corporation's Q3 2017 Earnings Call. Today's conference call 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, Leo. Good afternoon, and welcome to Redfin's financial results conference call for the third quarter ended September 30, 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](http://investors.redfin.com).

Before we start, note that some of our statements on today's call are forward-looking. We believe our expectations related to these forward-looking statements are reasonable, but our actual results may turn out to be materially different. Please read and consider the risk factors in our SEC filings together with the content of today's call. Any forward-looking statements are based on our assumptions today, and we don't undertake to update these statements in light of new information or future events.

During the call, the financial metrics, unless otherwise noted, will be presented on a GAAP basis and include stock-based compensation. 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. In the third quarter, Redfin accelerated our market share gains and continued to invest in technologies to make buying and selling a home easier and less expensive.

Revenue grew 35% year-over-year to \$109.5 million, with \$3.4 million in revenue from Redfin Now, an experimental service for buying homes from our customers. Excluding Redfin Now and other new businesses, revenues from home sales via Redfin's agents and our partner agents grew 31%. Compared to a 5% commission, we saved customers more than \$37 million in fees in the third quarter and over \$91 million year-to-date. Net income was \$10.6 million, an increase of 85% over 2016. These profits were seasonal as we do not expect to make money on the full year.



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Redfin's U.S. market share by value reached an all-time high of 0.71%, a year-over-year gain of 14 basis points. Our year-over-year gain in share has accelerated throughout 2017 from the first quarter's 10 basis point gain to the second quarter's 11 basis point gain.

Focusing on share lets us set aside the market's ups and downs to see whether our fundamental competitive position is improving. Gross margin declined from 38.1% in the third quarter of 2016 to 35.9% in 2017 due, in part, to the increasing proportion of revenues from Redfin Now and mortgage, initiatives that are too new to generate meaningful margins. But gross margins also declined in our core business of buying and selling homes through our own agents and our partner agents from 39.4% in the third quarter of 2016 to 38.1% last quarter. Especially in highly competitive coastal markets, it has become extraordinarily hard for customers to buy a home, lowering Redfin's close rates. For each home buyer who closes, we're spending more on customers who don't, on contractors who host home tours and on salaries and benefits for the agents we employ. As we experiment next year with lowering the number of homebuyers each Redfin agent serves, the gross margin impact will depend on whether more personal service leads to higher close rates. The most likely outcome is the gross margin change -- excuse me, the gross margins change very little from 2017 to 2018, with improvements expected in 2019 and beyond.

In part to deliver more personal service in 2018 and in part to drive growth, we also increased the average number of lead agents we employ from 1,010 in the second quarter to 1,028 in the third quarter. We've historically avoided hiring any agents in the third quarter as the home buying season starts to wane in August and September, and new agents typically take 6 months to contribute profits. But we're taking a different approach going into 2018. We believe we can capture more sales from the customers we meet at the start of the 2018 home buying season in February and even January if the agents we hire in the second half of 2017 have had more time to be fully trained. Given the 2017 growth in traffic and customers contacting our agents, we believe we would have had higher revenues if I hadn't been so cautious about hiring agents at this time last year.

One reason for our hiring confidence is the traffic to our website and mobile application, which is up 38% over the third quarter last year. As we predicted in our last earnings call, this is a deceleration from the second quarter's 43% growth. But among the top 10 U.S. real estate sites, redfin.com is still growing the fastest by a wide margin. We believe the rate of Redfin's traffic growth will continue to moderate as a by-product of our scale, but probably not dramatically. Over the coming year, we still expect strong growth due to the quality of our listing data, the speed of our listing alerts and the accuracy of our home value estimate.

Technology is also driving more visitors to contact our agents. The ability for new customers to start an online chat with a locally licensed Redfin employee expanded from Southern California to Northern California in the third quarter based on improvements to our support organization, that, on average, let us respond within 25 seconds to a customer's chat request rather than 40. We're expanding this to Seattle area customers in the fourth quarter. And if online chats continue to lead to in-person meetings with our agents and, ultimately, to profitable home sales, we expect a nationwide rollout in 2018.

Redfin's technology not only increased the number of customers we could reach last quarter, but the quality of our service. We continue to localize Redfin software for our agents to generate offer contracts in minutes, supporting Chicago in the second quarter, then adding Virginia and Washington, D.C. in the third. This should make our agents more productive in those 3 markets, but also help our buyers beat their competition to the punch on a hot home. We expect to continue expanding this software to additional markets in the coming months.

We've also added a new level of automation to tour scheduling. For years, we've confirmed the availability of the Redfin agent at the time requested by the customer, calculating the tour's duration and the order in which to see homes. Now for a small number of tours requested in the third quarter, we also automatically confirm the availability of the home being toured. This lets us instantly and completely confirm the tour without any caveat that a listing the customer asked to see may not be available to show at the requested time. Because of the wide variety of channels and customs for asking a homeowner or her agent about showing times, it will take us many quarters to offer this kind of speed and certainty for most home tours. But now that we've done it once, we know that eventually, we can do it at scale.

Another change that will take time to benefit the company is Redfin Mortgage, part of our vision of an all-digital closing. In its third quarter of operations, our mortgage business closed 13 home loans, all with Redfin homebuyers in Texas. We closed our first loan in the first quarter, then closed 8 in the second quarter, so growth has been deliberate, but customers have been happy, and we still expect this to be a major source of long-term revenue growth for Redfin. Before closing, we find an investor ready to buy each loan, limiting our risk. When reporting on future quarters,



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we'll update you on the mortgage business' growth without enumerating exactly how many loans we closed, which we disclosed in our first 2 earnings calls, only to set investor expectations that this new business is still in its infancy.

Our most important long-term project is to continue lowering the delivery cost and increasing the quality of our brokerage service. To lead this effort, Redfin hired 2 key executives in the third quarter. One is Judith Simon, formerly a CarMax Assistant Vice President of Service Operations and now Redfin's Vice President of Operational Excellence. Judith is responsible for standardizing our brokerage's processes for more consistent service, applying the data-driven approach we use for software engineering to brokerage processes for activating a listing, responding to an inquiry or closing a sale.

Keith Broxterman, formerly a Senior Vice President overseeing 11,000 customer support professionals at a business process outsourcing firm, is now Redfin's Vice President of Customer Operations. He initially joined Redfin as an agent and worked for nearly 2 years as a top producer, giving him deep understanding of the field organization he now supports. Keith leads the Redfin support centers that handle new customer inquiries and closing paperwork, so our agents in the field can focus on meeting customers. We know of no other brokerage taking such a systematic approach to efficiency.

An example of this systematic approach is the work we did in the third quarter to standardize how we close a sale. Studying the templates that our agents use to set up a customer's online deal room, we found more than 22,000 tasks for closing a sale. Those tasks include responding to property inspections, scheduling a visit from the lender's appraiser or checking the sewer pipes. Distilling those 22,000 tasks into a master list of 191 has created a major new piece of Redfin intellectual property. As we've learned from our efforts to automate tour scheduling, it will take at least a year to roll out this new standard process to the thousands of agents and support staff who have their own way of closing a sale now. But a standard process will over time let agents transfer more of their tasks to support staff, leaving the agents with more time for personal service and more sales. Standard processes should also make it easier to build software that automates some support tasks because our software engineers won't have to accommodate so many local variations on how to close a sale. This effort is only the most recent example of the close collaboration between process-oriented engineers, software engineers and real estate agents, all working for one company. It is the deepest source of our competitive advantage for making buying or selling a home better and less expensive.

Redfin Now, the experiment we began in January of this year to buy homes outright from our customers, bought 19 homes in the third quarter and sold 9. In the second quarter, we sold 5 homes bought in the first quarter and bought another 5 homes. All of the homes we bought in the second quarter sold in the third quarter. The Redfin Now customer typically nets less money than she would by hiring a Redfin agent, but gets this money sooner with more certainty and less hassle. In the third quarter, Redfin Now could have bought even more homes, but we've limited the money we could risk at any one time to below \$10 million. Based on October and early November activity, we do not expect purchases to reach our capital limit in the fourth quarter. The experiment's goals are: first, to determine whether a significant fraction of would-be home seller prefer Redfin-Now-style sale to hiring an agent; and second, to sell the homes at a profit, even after accounting for the cost of capital and our labor to fix up and sell each home. If we find that demand for Redfin Now is a significant fraction of the overall market, and we can keep making money on the homes we buy and sell, we'll likely pursue this as a business, not just an experiment. Otherwise, we'll cancel the experiment and refer customers interested in an on-the-spot sale to a partner. The experiment is limited to the Inland Empire between Los Angeles and Palm Springs and to San Diego. Redfin Now seems to be more popular in the Inland Empire, where home prices are lower. If we end up pursuing Redfin Now as a business, our online homebuyer audience, pricing expertise and agent network, would, we believe, let us compete effectively. Redfin Now accounted for less than 0.07% of Redfin's total transactions from the third quarter, but has an outsized impact on our financial statements because we have to recognize the entire value of a Redfin home -- Redfin Now home sale as revenue. We want investors to remember that Redfin spends almost all of Redfin Now revenues buying the homes in the first place. You should set aside this revenue contribution to our growth until we have decided to pursue this experiment as a business with profit expectations that we can share with investors.

As with mortgage, we have disclosed the exact number of Redfin Now deals to give investors a sense of scale for this experiment, but we don't expect to provide this degree of detail in future quarters.

Our last topic before Chris delivers our fourth quarter guidance is the overall real estate market. In our last earnings call, we noted that demand for homes, and not just supply, had begun to waver. And indeed, U.S. existing home sales declined year-over-year in September for the first time since July 2016. But even though buyer anxiety about rising home prices remain a concern, the number of homes for sale is once again the overwhelming



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issue, as September inventory was down for the 28th consecutive month by 6.4% from September 2016. We don't expect this problem to ease anytime soon. Builders are putting new homes on the market, but at prices much higher than the market's median, and especially in the most expensive cities where zoning changes are contentious, in areas far from most jobs. The larger long-term trend is a great migration from expensive coastal markets to more affordable Midwestern and Southern cities. This has already happened in places like Austin, Denver and Portland, and it is now transforming places like Charleston, Detroit, Nashville and Salt Lake City. We expect that this will drive higher sales growth for Redfin and other brokers in these markets for years to come, often at the expense of growth in the U.S.'s largest markets.

As Chris will discuss in a moment, the hurricanes led to a significant number of third quarter sales being deferred or canceled in Houston and Central Florida. The aftermath will affect Houston for many months to come as buyers bid low on flood-damaged homes, but Florida seems to be recovering quickly. The tax reform plans to cap the mortgage interest deduction from \$1 million of borrowed money to \$500,000, if passed, and it doesn't seem like it will at this point, would have a significant impact on 2018 sales, but it's too early in the legislative process to speculate about that.

With that, I turn it over to Chris.

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

Thanks, Glenn. Our third quarter was again solid with 35% revenue growth, matching our second quarter growth. We hit the midpoint of our revenue range despite an estimated \$400,000 in lost or deferred revenue due to Hurricane Irma. We said during our second quarter conference call that our third quarter guidance did not include any impact from Hurricane Irma in Florida and the Southeast as that storm had not yet made landfall in the U.S.

Total real estate revenue from our own agents and our partner agents grew 31% year-over-year. This revenue excludes Redfin Now, mortgage and other services. Brokerage revenue or revenue from home sales closed by our own agents increased 32% over last year, driven by 33% growth in brokerage transactions. Revenue per brokerage transaction was essentially flat year-over-year, consistent with our expectations. As we mentioned on our last call, we've been raising fees for homebuyers to offset growth and rollouts of 1% pricing in our listing business, which generates lower commissions. Our objective is to keep revenue per brokerage transaction flat.

Revenue from our partner agents grew 18%, driven by 16% growth in partner transactions. Revenue per partner transaction was only up 1% year-over-year as we have now fully lapped the partner program pricing increase that took place at the beginning of 2016. As a reminder, revenue per partner transaction was up 19% year-over-year during the second quarter as we were then lapping last year's changes.

Our other segment revenue of \$6 million was up from \$2 million in the third quarter of 2016. This revenue includes \$3.4 million in Redfin Now sales, revenue from title services from originating mortgages and from other partnerships.

Gross profit was \$39 million, up 27% year-over-year, including a near 0 contribution to gross profit from Redfin Now. Gross margin on the combined partner and brokerage business, known as our real estate segment, declined 130 basis points from 39.4% in the third quarter of 2016 to 38.1% in the third quarter of 2017. This was driven by a 102 basis point increase in personnel expenses and a 75 basis point increase in tours and field events. Our personnel expenses increased as we added more agents to support staff to better serve our customers, which Glenn noted in his comments about delivering more personal service. And we're touring buy-side customers to more homes per close as they sort through low inventory levels.

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 of these businesses, but combined, they lost \$358,000 in gross profit as we've staffed these teams for growth and have management costs against current small volumes.

Operating expenses showed continued leverage, growing 15% year-over-year and representing 27% of revenue, down from 31% of revenue one year ago. This performance is consistent with our long-term goal of leveraging fixed cost and improving profitability.

Our net income, including stock-based compensation and depreciation, was \$10.6 million, up from \$5.7 million in the third quarter of 2016.



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GAAP net loss per diluted share was \$0.50 for the third quarter of 2017. This loss was primarily driven by fair market value feature of our redeemable convertible preferred stock, which converted to common stock in connection with our IPO completed on August 2. This compares to GAAP net income per diluted share of \$0.03 in the third quarter of 2016.

Adjusted net income per diluted share, which excludes accretion income or expense for changes in the value of our redeemable convertible preferred stock and assumes its conversion to common stock at the beginning of the period, was \$0.12 for the third quarter of 2017. This compares to \$0.08 in the third quarter of 2016. For clarity, adjusted net income per diluted share includes stock-based compensation.

Now turning to our financial expectations for the fourth quarter. Total revenue is expected to be between \$89.2 million and \$93.2 million, representing year-over-year growth between 34% and 40%. We expect Redfin Now to account for \$2.2 million to \$3.2 million of the total revenue. Net loss is expected to be between \$6.0 million and \$3.9 million compared with a \$5.3 million loss in the fourth quarter of 2016. This guidance includes approximately \$3.2 million of stock-based compensation and \$1.7 million in depreciation and amortization. It assumes, among other things, that no additional business acquisitions, investments, restructuring or other legal settlements are included and that there are no further revisions to stock-based compensation estimates.

And with that, we'll open it up to your questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We'll take our first question from Mark Mahaney of RBC. We'll move next to Jason Helfstein of Oppenheimer.

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

So 2 questions. So the first, on the marketing side, marketing spend per monthly active user was down sequentially. So I guess, the question is, why not spend more with the idea that just the agents already fall off basically and unless you have more agents, you couldn't basically handle more traffic or you're getting plenty of traffic from the website? And then the second question, maybe on mortgage, with the expansion to Illinois, was this more to test another market or another state or because you're happy what you're seeing in Texas and are expanding it out? And could mortgage be material to next year?

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

Sure. So the first question was just about why we're not spending more in advertising. And you're right. Our agents have as much demand as they can handle, so there hasn't been as much pressure on ad-driven contact growth. Having said that, we're also investing in that team to increase our capacity to drive growth through advertising channels. So we think that we can invest more in media and drive more growth. We would just need to pair that with the campaign to hire more agents that's underway already. So those are the 2 forces that, I think, need to come together. As for the mortgage business, we have been pleased with the results in Texas. There are always operational challenges, just making sure that our mortgage advisers and our real estate agents work well together, but the customers have been very happy. And we have enough capacity in that business, especially with the executive team that we put together to run Redfin Mortgage to expand to Illinois and other states.

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

And just one further comment on that, which is you should not expect that there's a material increase in our revenue growth next year associated with mortgage as a business. We're continuing to be really excited about from a customer standpoint and continuing to build. And you'll expect to see that through the course of next year.



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

And then maybe just one quick follow-up. Could you share the mix between -- brokerage between buy side and sell side and maybe talk of that move as you're adding more markets at the 1% sell-side fee?

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

We don't speak specifically to that mix. In general, the listing business is growing faster, and our goal is to be at an equilibrium for a long time. We've had far more buyers than sellers because we've built a real estate search site for buyers, but the strategic advantages of listing homes are numerous. It gives us more leverage over other websites and it really lets us serve our buyers better when we also have our own homes for sale. So we will continue to drive listing share as a financial lever, but also as a market lever.

**Operator**

(Operator Instructions) We will take Mark Mahaney of RBC.

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

Great. Two questions, please. Could you just tell us or give us an update on where you are in terms of the 1% experiment? Do you think that, that's something that eventually you're confident will roll out to the entire county? I know you've rolled it out to a good number of markets. But is it proceeding the way you want it to? And is it -- are you -- do you think you can accurately tell how it's doing given the overall inventory supply challenges in the market? And then secondly, Glenn, could you remind us on what's the go/no-go decision on Redfin Now, like, when do you decide that you're fully into it or when do you -- or what you would see that would make you decide to stop it?

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

Sure. So I wouldn't describe 1% pricing as an experiment. It's possible that someday the market will reverse, and there will be more of a buyer's market than a seller's market. And then the home buying customer will become more price-sensitive. Today, the home selling customer is more price-sensitive. And we ran an experiment for a few years in a few coastal cities and also in Denver that demonstrated to us that our overall share will increase if we offer 1% pricing. So we have rolled that out fully to all the markets where home prices are high enough to support it. In a place like Baton Rouge, Louisiana, we do not expect to roll out 1% pricing because the homes that we're selling there are closer to \$200,000 than \$400,000 or \$500,000. And 1% of \$200,000 is only \$2,000, which really pinches our margins. So everywhere where we think it's cost-effective to offer that price, it is now available. And we expect that to continue until market conditions meaningfully change. That's basically our approach to 1%. It's reaching most of our customers, somewhere around 80%. And then Redfin Now is an experiment. It is possible that we will invest aggressively in that to build it as a business or that we'll decide that we would be better served working with a partner. But we expect to be working through that experiment over the next 6 to 9 months. And if we get a very clear signal, we'll make a decision sooner. If we get a mixed signal, we may put investors on notice that we'll take longer. Right now, it has sort of an artificial impact on gross margins because it generates so much revenue just because of the accounting, without generating significant gross profits. But other than that, it's not operationally intensive for us to run this experiment and it's something that the management team really wants to understand better. So far, the results have been encouraging, but we're still learning something new every month.

**Operator**

Our next question comes from Jason Deleeuw of Piper Jaffray.



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

I was wondering if we could get some color on the market share gains by the different cohorts.

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

We aren't really segmenting that either. Some of the color, you've already heard. Just that it's much easier for a homebuyer to get a house in the middle of the country than it is in Seattle, San Francisco, Washington or Boston. So we remain confident about our market share gains everywhere, but we're certainly seeing the fastest growth in the places where it's easier to get buyers into a home.

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

Got it. And then with the lower close rates and just taking longer for buyers to find and close on homes, what -- I was -- and I think I missed some of this, but what are all the levers that Redfin can pull on to kind of combat that trend?

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

Well, there's at least 2 or 3. So one of the levers that we manipulate is just between the quantity of contacts and the quality of contacts. So the number of people who are contacting our agents can increase if we make it easier for people to do so. But sometimes, those are less qualified opportunities to the agents. So I think we're one and the only real estate websites that has begun to significantly qualify customers who are seeking service from an agent asking, "Do you just want fast property access? In which case, we will serve you, but with a junior member of the team. Or if you really want an agent's guidance, in which case, we will prioritize one of our senior agents." So qualifying contacts has been one of the ways that we've addressed this problem. And obviously, it limits some of our growth. We're going to filter out people inadvertently who may end up buying a home. And then the second lever is just customer loads. So because customers get so frustrated because it takes so long to find a home that you can afford to buy, we have begun to lower the loads on our customers -- excuse me, on our agents, so that we can increase close rates. And it's possible that, that won't have the intended effect, but throughout our years of running this business, there's been a strong correlation between loads and close rate. So in different markets, we're just experimenting right now with having our agents meet fewer customers to see if being more proactive with the guidance, sitting down with a customer in a coffee shop to go over the realities of the market actually improve close rate and improve customer satisfaction. So that's the put and take with gross margin. If it improves close rate enough, that should actually mitigate some of the gross margin challenges that this tough market has posed to the business. If it doesn't, we're just lowering loads on agents without seeing that close rate improve.

**Operator**

(Operator Instructions) We'll move next to Brandon Dobell of William Blair.

**Brandon Burke Dobell** - William Blair & Company L.L.C., Research Division - Partner & Group Head of Global Services

Glenn, as you think about the agent pool from a couple of points of view: one, retention or attrition; two, are you having as easy of a time or a harder time finding the people that you want to bring in as agents? And then as you think about the pool of contractors that you work with and the same kind of questions, right, retention, churn, et cetera. Just trying to get a sense of that labor pool, how you feel about it these days.

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

In general, we feel good about it. We have increasing confidence that we can train someone who has never been a real estate agent to perform well as a Redfin agent. And I would say that, in part, because of the IPO, we've been more successful recruiting traditional agents. We used to try to convince people that a change was coming, that we were the future. And now I think many of them come to us believing that, that change has





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arrived. So the reports from the field have been that it has gotten easier to recruit agents. Having said that, there is so much pressure on recruiting every year at this time of year, so we feel that there should be significant demand at the beginning of next year. And it is always a hard run to get a lot of great people on board. So I don't want to be cocky about it. I think that recruiting is firing on all cylinders. We feel like we've got a large number of applicants. We've got great programs for training people, but it's go time. We really have to execute well. And on the retention side, we just haven't seen any meaningful problems. We always want to do better. One of my first goals as the CEO of the company is to be the best employer in real estate. And so that's a never-ending project. But we haven't seen attrition meaningfully increase. And mostly, I think our employees are as engaged as ever. On the contractor side, I don't have as much data. There, we have an arm's length relationship with the people who are hosting tours on behalf of Redfin. And we try to counsel the customer that when a Redfin employee isn't available to host this tour, you still get on-demand access. It's very fast, and customers love it, but you're not getting the same level of guidance that you would from an employee. And so that makes the customer less sensitive to churn than the churn we would see among employees where our customers are quite sensitive to that, and it affects our ability to grow the business.

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**Brandon Burke Dobell** - *William Blair & Company L.L.C., Research Division - Partner & Group Head of Global Services*

Okay. And then final one for me. As you think about the housing markets where the average home sale price is either too low or from the low end for what makes sense for how your model is set up, any color on what, I guess, the trajectory or timing would be you think for the process efficiencies or just how the business is organized where you can start to push that -- the lower limit or the bottom limit of what home sale price makes sense for you guys to operate in?

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

So that's a slow and steady progression. I think what's really going on is, first of all, that market is still addressable, but at 1.5%. 1% is almost a revolutionary price, where I don't think many competitors can compete at that level and still offer great service. So it's not as if that market isn't addressable by us today. We just can't be quite as aggressive in our pricing. And the history of the business has been that it used to be very hard for us to make money selling a \$400,000 home or a \$300,000 home. At \$200,000, you are getting to a place where large gains are less likely. We try to lower the cost per transaction by \$5 here, \$10 here, \$20. But the other dynamic that's really increasing our addressable market is rising home prices. Some of that doesn't contribute to our gross margins because instead of taking up a \$200,000 home and being able to sell it for \$210,000 the next year, we go down another \$10,000 and address a slightly larger market. So we take it as a gain in addressable market rather than a gain in gross margin because we're still fairly acquisitive about share growth. And the only footnote to that is that we used to see Redfin Now, the merchant business where we buy the house from the customer as being completely complementary within the same markets. But what we're seeing is that it's really a better solution for customers in that \$200,000, \$300,000 price point, whereas the brokerage service makes more sense at the higher price points. So it may be that those 2 businesses work well together to increase our total addressable market, whereas before we thought, "Oh, Redfin Now is going to be something that is really in the same core markets with the same customers." Very early days to draw a firm conclusion around that, but that's some of the early thinking.

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**Operator**

(Operator Instructions) We'll move next to John Egbert of Stifel.

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

Great. You noted some of the inventory tightness is because of large city pricing dynamics, which you expect to reverse from the migration to smaller cities over time. But it looks like your share from top 10 markets has actually held pretty steady for the last 2 quarters. If the migration outward does pick up steam, should we expect to see the mix of sales from top 10 markets continue to go down meaningfully from the current levels? And a question on the decel in total U.S. real estate sales volume. It seems like it came against a pretty easy comp from last year. I was wondering what type of market growth your 4Q guide assumes and how you're thinking about price versus sales dynamics over the next couple of quarters, if you have a view on it.



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

These are complicated questions. I think the first part of that just needs to make clear the difference between sales and share. So if you U.S. sales volume shifts towards the middle of the country, we would expect that our sales would also shift toward the middle of the country and grow more there. But to some extent, share should be unaffected by that because if it's harder to sell a house for us in Seattle or San Francisco, it's also harder for our competitors to sell a house. So we expect sales to be more volatile and more subject to market forces than share. And that's why we run almost every one of our markets by share. We have several projects in this earnings call, but one of them is to convey management's focus on market share over sales. If I'm talking to someone in San Francisco who's running that business, and she says, "It's just hard right now to get a closing." I say, "Well, how's your share doing because it's hard for everyone else, too?" And if that number isn't moving up at this steady incline, then there's a problem. And we haven't seen that problem. So that was the answer to your first question.

And then you asked about the kinds of assumptions we've made around Q4. We just haven't. There was a time when the tooth fairy always showed up in our budget, but that was before Chris Nielsen got here. These days, we assume that the market will be the same, unless it's doing extremely well. And then we pinch ourselves and say, "What if it got a little worse?" So we just expect the inventory crunch to continue. And I want to be clear about one premise to your question. Even though people are leaving the big cities because there's an inventory crunch, I don't know how much that will alleviate it. There is so much political gridlock in a place like San Francisco around building new homes, especially high-density homes, where it's a big building that blocks somebody's view and creates a parking snarl, that a very small number of people trying to live there still creates an inventory crunch. So I don't really see that inventory crunch getting much better in most of the coastal markets. I just see it starting to become a problem in markets where we never thought it would be. Hearing that there's a bidding war in Pittsburgh, who would have thought?

### **Operator**

And it appears that we have no further questions at this time. I'd be happy to return the call over to Elena Perron for any concluding remarks.

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

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

### **Operator**

This does conclude today's Redfin Corporation Q3 2017 Earnings Call. You may now disconnect your lines. And everyone, have a great evening.

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