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PRESENTATION

Operator

Good day, and welcome to the Redfin Corporation Q4 2019 Earnings Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Elena Perron. Please go ahead, ma'am.

Elena Perron - *Redfin Corporation - Head of IR*

Thank you, Brad. Good afternoon, and welcome to Redfin's financial results conference call for the fourth quarter and full year ended December 31, 2019. Joining me on the call today are Glenn Kelman, our CEO; and Chris Nielsen, our CFO. You can find the press release on our website at investors.redfin.com.

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

During this call, the financial metrics will be presented on a GAAP basis and include stock-based compensation as well as depreciation and amortization expenses. In the event, we discuss any non-GAAP measures to date, we will post the most comparable GAAP measure and a reconciliation on our website. All comparisons made in the course of this call are against the same period in the prior year, unless otherwise stated.

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

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

Thanks, Elena. Hi, everyone. Redfin's fourth quarter and net loss were better than we projected in our last earnings call. Revenue was up 88% from the fourth quarter of 2018 to $233 million, and losses narrowed from $12.2 million in the fourth quarter last year to $7.8 million in the fourth quarter of 2019. In our core business of brokering home sales through Redfin agents and other firms' agents working as our partners, revenues increased 31% compared to the same quarter last year. This was the fourth straight quarter that year-over-year revenue growth for real estate services accelerated. Our share gains also accelerated with a 13 basis point gain over the fourth quarter of 2018. This is an improvement over the 11-point share gains we saw in the third and second quarters of 2019, and the 10-point gains we saw in each of the two quarters before that.

RedfinNow, our business of buying and selling homes on our own account, grew revenues from $22 million in the fourth quarter of 2018 to $99 million in the fourth quarter of 2019. Over that same time, our other businesses primarily lending and title services grew 67%.

Perhaps most important, for the second quarter in a row, gross margins improved year-over-year in all of our segments. We expect gross margins to keep improving in 2020 because of efficiency gains in many of our businesses but also because we've now standardized on one, mostly higher price for our listing customers. In the past, customers and markets with high home prices paid Redfin a 1% listing fee. In other markets, we charge 1.5%.

Starting last December, in every market, listing customers who choose to buy a home with us pay a 1% listing fee, but otherwise pay 1.5% of the home price. This is a fee increase for about half of our listing customers, a fee decrease for about 20% and no change to the rest. The reason the new listing fee won't be a change for 30% of our customers is because starting in April 2019, we've already tested it in seven markets that had previously charged a 1% fee. The test thesis was that even at the higher 1.5% fee, no other broker could offer the full set of Redfin services and that our listing share would keep growing. This thesis was largely borne out.

In the test markets, we kept growing but more slowly, listing demand in the test markets grew several points slower than in comparable markets that still offer a 1% fee. The impact on share growth would have been higher but the test markets were growing traffic several points faster. Since these seven test markets already increased listing fees last year and other markets are actually decreasing listing fees this year, company-wide listing transaction growth in 2020 is likely to be stronger than what we saw in the test markets, but still slower than in years past.

Even if transaction growth slowed significantly, we expect that to be more than offset by the higher fee. The most encouraging finding from last year's pilot markets was that more sellers chose to use Redfin for the purchase of their next home. The customers -- these customers who both sell and buy still pay 1%, and Redfin makes more money by brokering two sales instead of one.

Our ads will keep promoting the 1% fee, while making it clear this depends on using Redfin for a purchase and a sale. We've been careful about increasing prices as Redfin's mission to put customer first starts with low fees. For years, we kept listing fees in major markets at 1% because home sellers are more careful than buyers about trying a new broker. But our data shows that our listing service can now compete effectively at a 1.5% fee, especially when many competitors charge 2.5% or 3%. Because many of our listing customers hired Redfin before the price increase, only about 60% of the listings that closed in the first quarter will be at the new price. We expect about 80% of our listing sales in the second quarter to be at the new price.

The long-term source of brokerage gross margin gains won't be further price increases but higher agent productivity. In the fourth quarter, transactions per agent increased 24% year-over-year with some of the gain due to a stronger housing market in 2019 and some due to an increase in the average number of customers served by a Redfin buyer's agent.

Fourth quarter agent productivity also benefited from the timing of agent hiring for 2020. Coming into the 2019 homebuying season, we hired agents in November and December 2018, whereas we largely waited to hire agents for 2020 until this January.

For 2020, we expect any gains in productivity for our buyer's agents to come from increasing homebuyer's success rate. Success rate is a measure of how many of the homebuyers we meet buy a home through Redfin. It has declined for five straight years. Some of this decline points to how our service needs to improve, some is because it has gotten harder for many Americans to afford a home. But some of the decline is because we've made it easy for people to tour a home regardless of how serious they are about buying it. As Redfin.com has attracted more casual visitors to our mobile website and as we've converted more of those visitors into customers through push-button request for a home tour, the likelihood that a Redfin touring customer will end up buying a home, whether from Redfin or any other brokerage, has declined since 2016 by 9%.

In our last call, we discussed the '17 market experiment that in November started to qualify the customers who signed up for a home tour. We've been careful about customer qualification because the ability to see listings whenever you want has made Redfin a symbol of freedom in real estate. But this experiment seems to have deterred only the most casual of lookie-lous from touring with Redfin, while flattering more serious homebuyers with our interest in their plans. The projected impact has been a modest and possibly significant increase in the likelihood that the people who sign up for a Redfin home tour end up buying a home, with minimal harm to our growth.

We've also begun to use our call centers staffed by locally licensed agents to qualify, by phone, some people who register for a tour. We only call the people who, through their online behavior, seem less likely to have understood what they signed up for. One group seems to appreciate a call explaining our service. Another never answers the phone and likely would have been a no-show for the tour, their tour is canceled.

Early results from this experiment suggest that in-person qualification can also increase customers' likelihood to buy a home. These experiments will take until May to roll out company-wide. By the second quarter, we expect to have made our first broad, significant improvement to the quality of the homebuying customers our agents meet. When these customers start to close on sales in the second half of the year, we expect our success rates to improve. We also hope to see first half improvements in homebuyer success rates, but these will be the result of changes to our field organization that we started planning last summer. We used our annual kickoff event on January 10 to inaugurate a new culture of sales performance. We still emphasize that a Redfin agent should always put the customers' interest ahead of a sale. But we've made it clear to our agents that earning our customers' business and finding a way for the customer to win still require energetic salesmanship. Our field organization's response so far has been an enthusiastic roar, giving us reason to believe we can execute better than ever in 2020.

Even as we've primed our field organization for a wave of new customers coming into 2020, we've also been improving the platform for generating that demand. Comparing the fourth quarter of 2019 to the same period last year, the average monthly visitors to our website and mobile application grew 21%, similar to our growth rate of 22% in the third quarter and significantly higher than North America's other major real estate websites.

To bolster redfin.com as an authoritative source of real estate information, we upgraded the Redfin Estimate, a machine-learning powered estimate of a home's value. The new median error rate for off-market properties is less than 6%, compared to a previous rate of 6.3%. We got these accuracy improvements while broadening the types of properties for which we calculate an estimate to include undeveloped land and multifamily properties. Covering largely the same properties as other major sites lets us more readily compare the accuracy of home value estimates. The Redfin Estimate has the lowest published error rate of any major site. An accurate home value estimate is a foundational competitive advantage for drawing potential customers to our site, but also for deciding how much RedfinNow should pay for a property, or what the list price should be for a home being sold by our brokerage.

We also recognize that the site is only one medium for building awareness of Redfin's brokerage. On Monday last week, we launched our 2020 mass-media campaign, with a television ad that shows Redfin.com drawing homebuyers to a listing as if by a magnet, pulling office workers across conference-room tables and dog-walkers through parks. The ad highlights our strength at turning online interest in a home into an in-person tour. Redfin homebuyers get immediate property access and our listing customers get more buyers viewing their home, which is one reason we sell homes faster and for more money than our competition.

Many years of advertising have taught us to be visual and literal about what we can do that other brokers can't. We tested this year's ad against its predecessors from 2018 and 2019, and by a wide margin, viewers rated it as more exciting and more persuasive about hiring a Redfin agent.

As in 2019, we produced the ad without an agency. This lets us use our own data-driven process for testing concepts at an early stage and leaves us with more money for shooting and placing the ad.

Beyond the ad itself, we expect to get more efficient at buying ad placements each year. Our most expensive media buying experiments on how often to run our TV ads and how broadly, ended in 2019. This lets us focus almost exclusively in 2020 on getting the most bang for our buck. From 2019 to 2020, we expect to spend about the same amount of money on mass media ads even as awareness of Redfin grows. Consumers know the names of many brokers, but our opportunity is to build the first iconic real estate brand known by what we stand for, to put the consumer first in our pricing, in our service, in our truth telling and innovative products. What will ultimately make our ads more effective than our competitors is not just the ad's creativity or the cleverness of our ad placements, but the products we're advertising. Redfin is investing massively in bringing groundbreaking new services to market, giving consumers choices and capabilities no other real estate company has. The new product we're investing in most is RedfinNow.

Now has kept growing fast but our focus is on margins, which improved from -4.3% in the fourth quarter of 2018 to -1.3% last quarter. We already discussed on our last call the October launch of RedfinNow in our 13th market, Las Vegas. We don't expect to add many more until at least the second half of 2020. We'll use that time to get better at pricing, renovating and selling homes, a process that already started in October when we shifted the authority to make an offer from the field to a central set of portfolio managers. This will let us be more programmatic about our investment decisions.

Our increasing price discipline has led to a decline in offer win rate through the third and fourth quarters of 2019. Homeowners don't always tell us about competing offers, so we don't know how often we get outbid by another institutional buyer. But among the people who contact us about a RedfinNow offer, more end up selling to RedfinNow than to a competitor. Sometimes this is because we beat out another buyer. Sometimes it's because another institutional buyer hasn't bid. What makes RedfinNow's year-over-year fourth quarter revenue growth of 359% remarkable is that we improved margins even as our competitors began what could be a destructive price war. The purchase activity of all institutional buyers slowed in the second half, but for the full year, the other major buyers seem to have made more aggressive offers, likely narrowing their average gain on a sale.

Redfin is comfortable ceding growth to competitors if we can't win the home at a price that can be profitable for us. As we've emphasized before, our disciplined customer belief that different economic conditions will favor different ways for consumers to sell their home, making RedfinNow a more appealing choice one quarter, and a brokered sale better the next. In today's low rate environment, RedfinNow charges homeowners a relatively low price for immediate liquidity. Rates are one reason institutional buying is growing quickly overall.

In hot markets, sellers choose our concierge service for fixing up homes, confident that a move-in ready listing can command top dollar. Meanwhile, brokered sales worked for a wider range of situations when customers just want to sell their home for a low fee. This is why a portfolio of listing services is so important. When listing customers reject the RedfinNow offer, we try to list their home through our brokerage. When a Redfin listing isn't selling, we sometimes offer a concierge upgrade to increase the property's curb appeal. At some point in the future, when we see a home that RedfinNow doesn't know how to buy at a profit, we may let partners like Opendoor take a crack. Already, Opendoor is helping us satisfy instant offer demand in markets that RedfinNow hasn't yet reached. In December, we expanded our Opendoor partnership from two markets to eleven. This approach lets us capitalize on homeowners' curiosity about an instant offer without tying up all our money in houses.

The other new business that's expanding rapidly is Redfin Direct offers, an online tool for unrepresented buyers to prepare and submit offers on Redfin listings. In the fourth quarter, we expanded Direct beyond Virginia and Massachusetts to Texas and California. Prior to the expansion, 6% of Redfin listings supported direct offers but now nearly 30% do. We still have plenty to do to broaden Direct offers' appeal, but already our listing customers in Direct markets are glad that we're their ally in recruiting consumers to buy their home directly, at a much lower fee.

Our new business investments aren't just focused on our listing customers. We're also investing in a more complete solution for our homebuyers. Redfin Mortgage capped a year of strong revenue growth and margin gains by expanding in the fourth quarter to Massachusetts, Michigan and Wisconsin. Nearly 60% of our brokerage customers are now in markets served by Redfin Mortgage. At the start of 2019, Redfin Mortgage was available to 45% of our homebuying customers.

Redfin agents at this time last year were mostly wary of recommending Redfin Mortgage instead of longtime lending partners. But 2019 was the year that Redfin Mortgage largely won our agents' trust. We now know that a sale is 20% more likely to close on time if our homebuying customers borrow their money from Redfin Mortgage and close the transaction with our title company, Title Forward. The upgrades to our own lender software keep reducing the cost of originating a loan. And in the fourth quarter, we also improved our process for selling loans, both through direct sales to Fannie Mae and in other ways. This increased revenue per loan by hundreds of dollars.

Entering 2020, Redfin is maturing from a one-trick brokerage into a company with the broadest product portfolio in our industry. We're still tinkering with Redfin Direct and our concierge service to make sure each is the right service being sold at the right price to the right customers. But other products like RedfinNow, Redfin Mortgage and our title service, are already taking off, with strong revenue growth and margin gains. These businesses are still in their early days, which is why, at least through the first half of 2020, we expect our technology development cost to grow faster than revenue, excluding RedfinNow. But as we complete the foundation for what can be a much larger company, our long-term commitment is to limit technology spending to grow more slowly than revenue, just as we've already limited spending on marketing and general administration.

Before turning the call over to Chris, let's discuss the market. The number of homes for sale at the end of 2019 in the U.S. was the lowest in at least two decades, 9% below January 2018 levels. In Seattle at the end of 2019, there was enough demand to buy every home on the market in three and a half weeks. Fifty-two other major metropolitan areas had less than two months of supply when a typical healthy market has six. Price pressure that used to be limited to a few cities like San Francisco or Portland is now widespread, leading Americans in search of affordability with fewer places to go than earlier in the housing recovery. This is why Redfin is braced for the most intense season of bidding wars since at least the first half of 2018. Across the industry, homebuyer demand is very strong, so the limit on sales growth will be inventory. In our own business over the last four weeks, the number of bidding customers -- of customers bidding on homes has far exceeded those who have won. A Redfin agent just told us about a bidding war with 30 other buyers in a far-flung area outside of Portland, Oregon this month. The property being fought over was a mobile home.

This situation can last longer than most realize as the law of supply and demand works slowly in real estate. Agents struggle to put deals together in a rapidly escalating market with buyers looking at sales from earlier months and sellers thinking about how much higher prices could go in the months to come. Appraisers initially refuse to support higher offers, leaving buyers who won a bidding war unable to get a loan for the promised amount.

Even when rising prices entice more sellers to list their home, some first take months to fix up their properties. Others can no longer get the credit to own 2 homes at once and get stuck. In a frenzied market, they refuse to sell their current home before finding a new one to buy, but can't buy the new one without cashing out the old one. The restrictions we put on consumer credit after 2008 are now twelve years later, limiting housing liquidity.

For all these reasons, we think that the sellers' market will last at least through the first half of 2020. RedfinNow is buying homes aggressively. Our sellers' agents are pushing hard to get more money for our listing customers, and our buyers' agents are making offers left and right, but still feel wary about how many will actually stick. It's going to be a wild ride. Take it away, Chris.

Chris Nielsen - *Redfin Corporation - CFO*

Thanks, Glenn. We finished 2019 on a high note, delivering another quarter of strong top line growth and improving year-over-year gross margins in each of our reported segments. Fourth quarter revenue was $233 million, up 88% from a year ago.

Real estate services revenue, which includes our brokerage and partner businesses grew 31% year-over-year. Brokerage revenue or revenue from home sales closed by our own agents was up 32% on a 34% growth in brokerage transactions. Brokerage revenue per transaction was down 2% year-over-year, reflecting continued mix shift towards our listing business. Revenue from our partners was up 14% on an 8% increase in partner transactions. Revenue per partner transaction was up 6% year-over-year. The properties segment, which consists of homes sold through our RedfinNow program generated $99 million in revenue, up from $22 million one year ago. Our other segment, which includes mortgage, title and other services contributed revenue of $4 million, an increase of 67% year-over-year. Total gross profit was $40 million, up 51% year-over-year.

Real Estate services gross margin was 32.1%, up 430 basis points year-over-year primarily driven by a 340 basis point decrease in personnel costs.

Properties gross margin was -1.3%, up 300 basis points from a year ago primarily driven by a 240 basis point decrease in home purchase costs and related capitalized improvements and a 30 basis point decrease in personnel costs, each as a percentage of revenue.

Other segment had a negative gross margin of 24.9%, an improvement of 310 basis points from a year ago as our mortgage and title businesses continue to scale.

Total operating expenses increased 20% year-over-year and represented 20% of revenue, down from 31% of revenue one year ago. Technology and development expenses increased 41%, driven by an increase in personnel costs. We expect technology and development expense growth in the first half of 2020 to remain largely consistent with the fourth quarter as we continue to invest in newer businesses such as mortgage, title and RedfinNow.

General and administrative expenses grew 12% year-over-year and marketing expenses increased less than 1% as we did not run any brand advertising campaigns and saw gains in performance marketing efficiency, leading more customers to try our services with less spending for online ads.

Glenn mentioned earlier that we'll spend about the same amount on mass media in 2020 as in 2019. In 2020, we'll be slightly less weighted to the first quarter though. Our net loss, including stock-based compensation and depreciation was $7.8 million compared to a net loss of $12.2 million in the fourth quarter of 2018. Diluted loss per share was $0.08 compared with a loss of $0.14 per share one year ago.

Before moving to our first quarter outlook, I'd like to briefly summarize our full year 2019 performance. Our customers booked over $30 billion in real estate transactions. Compared to a 5% commission, we saved our brokerage customers over $180 million. We delivered full year revenue of nearly $780 million, up 60% year-over-year and gross profit of $144 million, up 21% from 2018.

Our total operating expenses grew 37% with a 210% increase in offline marketing expenses. And net loss for the year increased from nearly $42 million in 2018 to over $80 million in 2019.

Now turning to our financial expectations for the first quarter of 2020. Revenue is expected to be between $179 million and $188 million, representing year-over-year growth between 63% and 71%.

We expect our properties segment to account for $69 million to $74 million of that revenue. Net loss is expected to be between $72 million and $68 million compared with the $67 million net loss in the first quarter of 2019. Our guidance includes approximately $9.1 million of stock-based compensation and $3.2 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 now we'll open it up for 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*

I guess I'll ask two. One on RedfinNow and then just a model question on real estate gross margin. Given what -- is there any way you can talk about cohorts? So obviously, you've been adding markets and that weighs on the profitability of RedfinNow, yet on a reported basis, you have enjoying improvement. Are you profitable on a unit economic basis in some of the early markets? Or just any other commentary you can give us on how you're thinking about that longer term? And then on gross profit, any reason why real estate gross margin should not improve at a similar rate to what we saw this quarter through the third quarter of this year, especially given your comments about the market for the first half of the year?

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

Jason, I'll comment on RedfinNow and Chris will comment on gross margin. We do not have cohorts that we're publicly discussing for RedfinNow. I don't think it's just a matter of time. We have to get better at pricing properties and that's exactly what we've done over the past two years. It gives us confidence that we can continue to do so. You make money on almost every property you buy. But when you miss, it really costs you. So the misses just have to get fewer and farther between. I think there's also just some question of how we can get our renovation costs down so that we can renovate the home more quickly and more cheaply, and we're confident about that, too. So I don't think it's really a question of maturity as much as it is a question of just improving our craft.

Chris Nielsen - *Redfin Corporation - CFO*

This is Chris. We're not providing guidance on real estate services gross margin. We do believe the pricing change that Glenn talked about earlier will be a positive for gross margin during the year. If we get the kind of output that we expect from that pricing change, it will have that effect. And then Glenn further talked about some of the longer-term things we're doing that will drive agent productivity. So we do think that there's a positive trend but aren't providing specific guidance there.

Operator

We'll take our next question from Tom White with D.A. Davidson.

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

Glenn, thanks for the kind of color around the rationale for unifying the sell-side pricing. Could you maybe comment or sort of quantify maybe the uplift you saw in some of the test markets about when it comes to customers who use Redfin for both sides as opposed to just the sell-side after introducing the pricing change? And then, Chris, maybe just clarify on exactly how the accounting will work? Will you guys sort of reserve for possible future rebates? Is that how it will work? And how is that may be reflected in the first quarter real estate segment revenue guidance?

Chris Nielsen - *Redfin Corporation - CFO*

Yes, I'll go ahead and take your second question first. So we do account for the possibility that a customer will have a second transaction in the future. We made that accounting adjustment and reserve for that in the third and fourth quarters of 2019, and that's reflected in our guidance for 2020 as well. Just for what it's worth, customers often have those 2 transactions very close together. And so it makes it really easy to record that. But then there are some customers who have a longer time frame between those 2 deals, and that's how we handle it.

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

And Tom, I would expect the pricing change to have a negative effect on transactions overall. So we saw a listing decrease that was larger than the increase in homebuyer transactions. Neither was major, and we expect, obviously, both businesses to grow for other reasons because of higher brokerage awareness and more traffic and all the rest. But if you're trying to pull apart, whether we're going to get enough buyers to offset some of the sellers who are put off by higher price, my guess is that we won't. But the magnitude of both those numbers was similar.

Operator

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

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

Congrats on a great quarter. On the brokerage transactions for agent, that was a really, really good number for you guys, I feel like this quarter, so good work there. Just framing that up annually, it looks like you guys have been running kind of in the low to mid-30s range or so over the last few years. It looks like there's obviously room for that to maybe go higher, but I don't know if you can talk to a long-term goal there? Or if you could maybe help us understand how many deals maybe the upper quadrant of agents are doing? I'm just trying to get a better sense for how much higher that can go.

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

We don't have any forward-looking guidance on agent productivity. What we discussed is what will drive agent productivity. I don't think we're going to increase the number of customers assigned to an agent. But instead, we're going to qualify the customers better, improve the quality of service so that for the number of customers an agent meets, we close more of them.

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

Okay. That makes sense. And then I see that you guys already filed the 10-K. So Chris, good work from the quick turnaround there. But I'm guessing my question is going to be answered in that filing, but if you guys have this on hand, what is -- what did you end the year at as far as percent of buy side versus listing transactions?

Chris Nielsen - *Redfin Corporation - CFO*

We did include that in the K, and around 44% of transactions were on the listing side for 2019. That's up from -- I think we said just over 40% in the prior year. And big thanks to the finance team for the...

Operator

We'll take our next question from Ygal Arounian with Wedbush Security.

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

I have two. I want to dig into the impact on the listings and on the buy side from the pricing changes. And so Glenn, you noted that there is a little bit of an impact but even at 1.5%, you're still well below most of your peers. So when people are put off by that increase from 1% to 1.5%, where are they going? What -- they're going to different brokerages, but what's the thought process from not paying 1.5% versus going somewhere else and paying more? And then why isn't it driving more loyalty on the buy side? That 50 basis points loyalty reward seems like it's pretty attractive. So I would think that you would get a little bit more from the buy side there.

And then second question, completely different. Just on the competitive environment, and RE/MAX just launched a new -- their new kind of consumer-facing website and app. Keller Williams is -- either they just did or is about to. And as they kind of move in the direction of basically creating an offering, at least on the website, that's similar to what you guys are doing, similar to Zillow and building a portal. Just your thoughts on how that can change the competitive environment and the dynamics around that.

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

Sure. So I think on the first question, it's just easier to match the price at 1%. There were very few agents who are willing to match that price. And there are still very few agents who are willing to match 1.5%. I just wouldn't think about it as a brokerage offering that price across all of its agents all of the time. I'd think about one living room, where you have an agent you've known for many years, who gets very close to either 1% or 1.5%, and you decide to go with him instead of Redfin. That happened at 1%, it will probably happen a little more often with 1.5%. But we do feel that the product has reached a level of maturity where people see the yard signs, they know our sales history, they talk to customers who have been successful, and we compete at a very strong -- from a very strong position. So we feel like we can charge this price. The test showed that we can charge this price. But you can never kid yourself when you raise prices, it's going to affect demand. And you have to respect the consumer about that and be very careful, which is why we went through a nearly year-long process to test that.

As for why it doesn't drive more sell-to-buy activity. I think it will. There are some sellers who aren't buying. You have a customer who's put their parents in a nursing home or someone who's leaving the country or something like that. But it does take some time for that data to cure because at times, people sell in one quarter and buy the next. So Chris commented on how mostly that resolves itself fairly quickly, and we can handle it in our accounting. But I still think there's some upside in that attach rate.

And then as for RE/MAX and Keller Williams and all of that, those are formidable competitors. I think their service is one that we try to beat every day. It's just that on the Internet, there's now such an advantage to incumbency. And I don't want to be complacent about that. But I think it's really hard to get a high placement in the Google Index even if you copy our site, pixel for pixel, which several brokerages have now tried to do. So we just haven't seen a history of those sites gaining traction. And we think that some of the things we've done with machine learning, especially around recommendations and estimates, are just generations ahead of what many other websites have online today.

Operator

Our next question comes from Mark Mahaney with RBC.

Mark Stephen F. Mahaney - *RBC Capital Markets, Research Division - MD & Lead Internet Research Analyst*

Okay. Great. I want to ask three questions, please. The gross margins in RedfinNow that look like they're improving, but we're still talking negative gross margins. So Chris, do you want to give us any sort of goal as to where you think those gross margins -- when they could turn positive? And how positive they could actually turn? Second, Glenn, on this pricing change, this is kind of a big step, and it sounds very positive. I just want to press you a little bit like you've tested for almost a year, that's good. The seven markets. Any color on those seven markets just so we can gain some conviction that, that's been amply tested in markets that are, whatever, representative of the entire country. And I guess your explanation was that even though you had a small decrease in the transactions on the sell side, you had a small increase on the buy side. So net-net, it was a small increase in transactions, but the net take rate improved, and that's why this is going to be accretive. I just want to make sure I understand that and what those markets were.

And then maybe the last thing, Glenn, if I could ask you. You always provide very useful color commentary on the market. What is a goldilocks market? What's the best market for Redfin to be in, like, when you think about -- what causes your business to perform best? Just describe what that market is and when is the last time we actually saw that?

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

You want to take the first one, Chris?

Chris Nielsen - *Redfin Corporation - CFO*

Yes, So I'll talk about properties gross margin. We've long said, we think this is a low single-digit gross margin business. The team is making progress to that. I think we were encouraged in the fourth quarter that, in particular, we had an improvement of 240 basis points on home purchase costs and related capitalized improvements. That means we're buying and renovating the home closer to what we want to sell it for and a big improvement year-over-year, so that's the commentary I would give there. We have not set out a time frame to get to that territory but certainly, the last several quarters are encouraging in that way.

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

And I would just add that we've prioritized margin over growth and still grown like crazy. We've got people in the RedfinNow team coming into our office, looking for a license to ill where we can compete with other iBuyers who are really aggressive on offer prices. And Chris and I have been really disciplined about saying the only question about this business isn't whether people want it, but whether they want it at a profitable price, where we've really priced in the cost of flipping the home into the offer. So I think growing as fast as we have when there's been that much margin gain is encouraging, and we are absolutely committed to finding the size of the market at a profitable price because you can buy growth if you're willing to have an unprofitable price.

So as far as the listing price, the markets were representative. I think we're very disciplined about that. Obviously, conditions can change from 1 year to the next. But in terms of the types of markets we chose and the length of the experiment, another company might have taken a price increase 6 or 9 months earlier than we did. And we've just been in this business long enough to know that you need a broad set of markets, and you need to let that change propagate through the seller psyche over many months.

So I do feel confident that the signal we got was a clear signal from 2019 and pretty darn confident that it's going to hold in 2020. I want to be clear that it didn't decrease transactions in an absolute sense. It's just when you compare the growth rate for markets at a lower price to the growth rate for markets at a higher price, that growth rate for markets at the higher price was slightly slower. And the net effect on transactions was slower growth because even though we saw more sell-to-buy activity, it did not completely offset some of the headwind on listing transaction growth.

And as for goldilocks market, we just want more inventory. But I tried to make this point that I do think Redfin has a fairly diversified approach. More inventory just makes it easier to match buyers and sellers, you can run a more profitable business. I think most people, when they look at the market, are focused on what will drive revenue growth. But I'd say we're just as focused on what will drive margin because when an agent really struggles with winning an offer, where you have to submit five, six, seven offers to get one to stick, that affects your margins as much as your revenue growth or more, and we're just very margin focused. But the reason I emphasize product diversity is that if I thought rates were going to be low forever, I think I would be one step more aggressive about RedfinNow. I think the properties business is an artifact of a very low rate environment, and while that environment is likely to continue for some time, we know that the cycle will turn both on interest rates and generally the seller's market. And then I'd rather have a brokerage business that's less capital intensive, less rate sensitive. And so I think the way to be prepared for different markets is to have different products.

Operator

We'll take our next question from Naved Khan with SunTrust.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Glenn, you talked about the partnership with Opendoor expanding to eleven markets. Can you maybe just talk about the strategy there? Is it that it just makes more sense -- economic sense to have -- to go out of the partnership versus maybe having RedfinNow in every single market, or how are you thinking about that? And then secondarily, if I were to think about the core brokerage business for 2020, are there any initiatives in the works that can contribute to margin gains this year on top of what you already have?

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

Any new businesses?

Chris Nielsen - *Redfin Corporation - CFO*

No, on real estate services.

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

Well, you can drive margin gain beyond pricing.

Chris Nielsen - *Redfin Corporation - CFO*

And what we talked about on the call.

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

Okay. Got it. So first of all, in the Opendoor partnership, there are 2 reactions. The first is that our website is still radically undermonetized, in my view. At some point, we're probably going to offer consumers a Redfin Mortgage. Today, it's only available to people who use our brokerage. But we know that there are people who have a cousin who's a real estate agent, but who love Redfin.com. And so we just want to offer more products to those people. And RedfinNow can't scale fast enough for us to offer instant offers in every market across the United States. But the other discipline to remember is just that we want to be picky about which properties RedfinNow buys. And so that means that to serve customers who want an instant offer, sometimes, you have to have other players who are willing to bid on those properties. There are different companies who have different areas of expertise, different appetites for risks, so they may be willing to buy a home that we don't have the expertise to buy at a profit. And we learned this from running the brokerage. It is so hard to run a brokerage with fixed cost and fixed capacity when demand is so seasonal and cyclical. And what has given us the ability to have traffic scale with the Internet but still run a very disciplined margin positive brokerage is that when we get too busy, we send demand to our partners. And that's true in the brokerage, it's true in the iBuying business.

As far as gross margin initiatives, we really tried to lay out the main areas of upside. The listing price increase is going to be the first one. And long term, we think that we are better positioned to improve homebuyer success rates than anyone else because we control the website and the service. The website qualifies customers, the service lets us serve them better. We can really figure out where the problem is and solve the whole problem because we own every aspect of solving the problem. So I still think that we're going to be more efficient than any other brokerage because we control every part of the transaction and every part of the search.

Operator

We'll take our next question from Jack Micenko with Susquehanna Financial Group.

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

I hopped on a little late, so if these were covered, I apologize. Glenn, the first bullet on the press release talks about market share. And I'm curious what the pricing change and some of the commentary about a little bit slower activity. Are you willing to maybe sacrifice a little bit of market share or slow that market share take down at the expense of margins? Is that the right message?

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

You should see the agonized look on my face right now. I love taking market share. I love it. But I do think that you have to charge the right price for every product. The history of consumer companies is littered with businesses that bought share at the wrong price and at the wrong margin. I don't think the trade-off is going to be significant or we would have flagged it as such. We ran experiment for a year across a large number of markets, and what we found is that those markets still grew very fast. And the markets we're talking about are fairly sizable. So you saw share gains accelerate throughout the year, even as we were running this price increase across seven of our larger markets. So I don't want to be naïve about it and think we can charge whatever price we want and still take share. It's like squeezing blood out of an onion, getting me to agree to any kind of price increase because I just love saving consumers' money, the whole company does. We think we've done this prudently. We think we're still going to grow the business very nicely.

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

Okay. Fair enough. And then as a follow-up, we guided -- or you guided to a Red's properties number of $80 million, $85 million, it came in at $99 million. Just trying to understand the delta. Did you widen the buy box? Is there less competition? Did you maybe sell more than you thought? I think, a year ago, you ended up selling more than you bought of the revenue number. Just trying to figure out maybe what happened on that business that the top line came in a lot better than you had expected three months ago?

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

The Fed dropped rates, homebuyer demand shot through the roof, we sold off most of our inventory more quickly than we thought. And I think we can look back on that and say that we should have been more bullish buying homes in Q4 than we were, but we'll take that every single time. If you're betting on macroeconomic conditions, you really should be a REIT. And instead, we're going to wait to see that demand before we buy homes to satisfy it. So right now, RedfinNow is really scrambling to buy as many homes as we can because we know it's on like Donkey Kong.

But I think in December, we felt like we'd sold out most of our inventory, and we really needed to replenish it. So that's just what happened, is everything we had or nearly everything we had, we sold.

Operator

We'll take our next question from Brent Thill with Jefferies.

John Robert Colantuoni - *Jefferies LLC, Research Division - Equity Analyst*

This is John Colantuoni on for Brent. For the RedfinNow business, can you contextualize how much of the improvement in gross margin was the result of operational improvements versus algorithm improvements versus an improvement in the broader housing market? Also, did you alter your approach or strategy to buying and selling homes as home prices moderated earlier in this year to help reduce the impact of a softening market? I'm just -- we're just curious whether you feel better equipped to make smart purchasing decisions, if there's ever an unexpected downturn in the future.

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

I think most of the margin gains have been around pricing but not all of that is algorithmic. We talked about this programmatic change where the people who are empowered to bid on homes aren't necessarily in the field. Some of them are headquarters-based. And the reason we did that is because when you get in your car and you drive out to a house and you walk through it with the owner and you understand how desperately needs to sell it, it's hard to put in an offer that is unlikely to be accepted. You've invested your time and your emotion in it. And having someone who's more investment minded make that decision, I think, has given us better discipline. And I used to have the opposite thesis. They used to feel that we needed to walk the home just to make a good pricing decision. So the improvements in the Redfin Estimate and all the algorithmic work we've done provide better guidance, to the people making those bids has helped. But also just where those people sit and how they're trained and our process for deciding which properties to bid on and how much, has also improved.

And then to your second question, we do change our margin of error when the market gets really hot. So some of that is seasonal. It's hard to own homes, say, in October, because you know that the selling season has passed you by, and it's likely that you're going to have to own it until January. And then some of that is more cyclical that if you are really nervous about a recession or something like that, your appetite for risk goes down.

So in general, I would say, we have a lower appetite for risk than almost any other iBuyer, you're going to see more volume from them. And I hope that the benefit to us is margin. But even within that context, I would say we are feeling more aggressive now than in the past just because demand is so strong and inventory is so low.

Operator

We'll take our next question from Brad Erickson with Needham & Company.

Bradley D. Erickson - *Needham & Company, LLC, Research Division - Senior Analyst*

Just two to follow-up. One, you said the unit growth sounds like will take a step down to your starting out the year because of the price increase. Also, I guess the inventory situation doesn't really help that. If you had to guess kind of which the bigger contributors to any unit growth deceleration we might see in 2020 between the price increase and then the inventory situation, kind of which one is bigger. And then second, just for Chris, on the cash flow statement. It looks like you saw some working capital headwinds reverse in the quarter, cash flow from ops is positive, something like $25 million. Can you unpack that number between kind of the core real estate business versus the properties business and their respective contributions?

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

I'm worried that the assumption behind the first question around decelerating transaction growth is too bearish. I want to be careful here because I don't want to promise you a rose garden. Our guidance is what it is and we've carefully considered it, and I don't need to add much more color to it. But we didn't come into the year worried about transaction growth in a significant way because of the pricing, just based on the experiments we ran.

There will be probably a moderate headwind on listing transaction growth. But I just don't want to make more of it than that. And the inventory shortage is pretty significant. Right now our buyers are really frustrated already, and it's just early for them to feel that way.

Chris Nielsen - *Redfin Corporation - CFO*

On cash flow, probably the biggest change from the last quarter was that the inventory continued to draw down in our homes business. So that brought dollars back onto the balance sheet out of inventory and into cash, so that's probably the biggest change you're seeing there.

Operator

And we'll take our next question from Ryan McKeveny with Zelman & Associates.

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

Nice drive on the quarter. One question on the agent count side of things. So it's the second quarter in a row that we've seen a sequential decline. And I know you mentioned some of the hiring patterns this year starting in January as opposed to November, December. I'm curious if you can talk about the other side of things on the performance standards that you mentioned last quarter. Is that a function of this as well? Just any sense of how kind of the performance standard side of things is going. And then likewise, I know you won't give specific guidance on the agent count into 2020. But when thinking about where we are, like the hiring patterns in, let's say, January, should we expect agent count to be up in 1Q '20 versus 4Q '19?

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

Yes. We've been hiring agents left and right. This is the part of the year when we really bulk up. So we host all these home tours in the first quarter, and then we really start closing sales in the second quarter, which makes our business quite seasonal, especially in gross profit. The performance standards have nothing to do with agent head count in Q4. Involuntary attrition has increased in the first quarter, and we expect that to be more significant in the second quarter. It's not a massive impact. We'd said before that about 20% of our agents are being affected by those standards, but you shouldn't think that 20% of them are going to get fired or resign ahead of being fired because most of them are really trying to figure out a way to improve their performance and they do. So involuntary attrition will be up, but it's only going to be a few points. And we're still able to recruit quite effectively. So when we have demand, we're going to be able to serve those customers.

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

Got it. That's very helpful. And then one other question. Any update you can give on Canada? Where things stand as far as kind of rolling out the brokerage operations, any incremental partnership opportunities? Just kind of high level, where things stand and where that can kind of go in 2020?

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

Well, it's almost exactly the one-year anniversary of launching Canada. I just don't think you can expect those markets to be financially significant. It takes time to build website traffic, to build a brokerage. We really love the team in both Toronto and Vancouver. They have been resourceful. They have served customers well. We are proud of what we've done there, but we still are going to take some time to build the business.

Operator

And we'll take our next question from Stephen Sheldon with William Blair.

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

This is actually Josh on for Stephen. I know it's still the early days for the ancillary services. But since you talked about the expansion into new markets and broader customer representation and our buy-ins from the agent, I'm just wondering if you could give us a sense of, sort of, the early on attach rates for some of those services? And then sort of anecdotally discuss maybe where that can go? Could it represent a quarter of your transactions or even 50% of your transactions or more?

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

Sure. So I think that's probably the biggest story of 2019. Those businesses were eating it a year ago. Attach rates were really low. Gross margins were terrible, and we really had a crisis of faith about them a year ago. And now they are the mouse that roared. So Mortgage has done very well, hitting our attach rate goals, competing effectively on price, and then Title has really broken into the black in a serious way, where we were running that business barely making any money, and now it's making significant money. So the attach rate on Title is going to be higher than Mortgage because the consumer is always going to shop price on Mortgage. We think that we're going to be effective on price because we don't have customer acquisition costs in Mortgage. But there's still going to be times when Wells Fargo or some other lender is willing to take lower margins than us or even buy the business just because they have idle hands. So part of it is going to be that we're going to get a high attach rate on the brokerage, and part of it is, at least with Mortgage, at some point, I do think we're going to end up offering consumers a Mortgage who don't use a Redfin agent.

As we said, the website is just under monetized. There are people who use our website and never give us a penny because they end up working with a different agent, but they can still hire Redfin Mortgage because our prices are so good. So I don't have forward-looking guidance on exactly what we think attach rates can be for those two products or what the mix will be three years from now. But the reason we really spent so much money in research and development to build our own loan origination system is because we think those businesses can be significant.

Operator

And ladies and gentlemen, at this time, I would like to turn the conference back to Elena Perron for closing remarks.

Elena Perron - *Redfin Corporation - Head of IR*

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

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

Thanks.

Chris Nielsen - *Redfin Corporation - CFO*

Bye.

Operator

Ladies and gentlemen, this concludes today's call. We thank you for your attendance and participation, and you may now disconnect.
