Q3 2023 Prepared Remarks

Good afternoon and welcome to Redfin’s financial results conference call for the third quarter ended September 30, 2023.

I’m Meg Nunnally, Redfin’s head of investor relations. Joining me on the call today is Glenn Kelman, our CEO, and Chris Nielsen, our CFO.

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.

On this call, we will present non-GAAP measures when discussing our financial results. We encourage you to review today’s earnings release, which is available on our website at investors.redfin.com, for more information relating to our non-GAAP measures, including the most directly comparable GAAP financial measure and related reconciliation. All comparisons made in the course of this call are against the same period in the prior year, unless otherwise stated.

Lastly, we will be providing a copy of our prepared remarks on our website by the conclusion of today's call and a full transcript and audio replay will be also available soon after the call.

With that, I’ll turn the call over to Glenn.

CEO Remarks

Financial Overview: Third-Quarter Profits

Thanks Meg, and hi everyone. Despite a housing market that has gone from bad to worse, Redfin gained share and earned adjusted-EBITDA profits in the third quarter of 2023. Our third-quarter results from continuing operations show how much more efficient we’ve become over the last year: revenue declined year over year by 12%, but gross profits increased by 8%, and adjusted EBITDA improved by $20 million, with improvements in nearly every segment. Including the gain from closing RedfinNow, the year-over-year increase in our adjusted EBITDA was $59 million.
New Loan Gives Us Ample Time to Make Money

We’ve also raised capital. In the third quarter of 2023, we bought $36 million of 2025 debt for $29 million, leaving $235 million remaining. Then at the end of October, we secured a $250-million loan from Apollo Global Management, which we can use to retire the remainder of our 2025 debt, giving ourselves more time to develop a significantly profitable business before our 2027 convertible notes are due.

From the Second Quarter to the Third, Share Gains Improve

The share of home sales brokered by our own agents and through referrals to our partner agents also increased, from .75% in the second quarter of 2023 to .78% in the third quarter. Our share is still below its level from a year ago, as we haven’t fully recovered from the share lost in the first half of 2023 due to layoffs and the closure of RedfinNow, but we’re glad to be growing again. For the first time since our earnings call discussing results from the second quarter of 2022, our quarterly guidance forecasts the possibility of year-over-year revenue growth.

In Every Business, Significant Operating Leverage

Any growth should be very profitable, as every one of our businesses has gotten more efficient, none more so than our core real-estate services business. Despite real estate services third-quarter transactions declining 20% year-over-year in line with a housing downturn, and revenues declining by 16%, adjusted EBITDA improved by $9 million.

More Growth Ahead

There will still be ups and downs, but mostly we plan to keep drawing visitors away from rival sites due to the addition of rental and now new-construction listings. As we recruit a more sales-driven agent with completely variable compensation, we also expect to take more sales from other brokers.

A More Digital Business

We’re getting more gross profit from less revenue in part because of increasing contributions from high-margin businesses. The simplest, most significant change in our strategy has been to become more digital, by routing more real-estate-services demand to partners instead of employees, and by building our rentals marketplace.

What a Difference a Year Makes: $3 Million in Digital Profits

This strategy has led to the formation of several new digital businesses, still small enough to be grouped with Title Forward in our other segment. That segment grew 54%, and generated more than $3 million in third-quarter adjusted EBITDA, up from roughly $50,000 in the third quarter of 2022.

Our Other Segment Is Incubating Three New Sources of Profit

Those profits are largely the result of businesses we launched in the second quarter of 2022: a mortgage marketplace for connecting Redfin.com visitors to lenders, and display ads on Redfin.com. We expect to
develop more sources of digital revenue over the next year. Just last week, Redfin.com published the first batch of new-construction listings from Zillow, which we expect to add more than $750,000 in profits per quarter.

Redfin Has Become More Efficient and Less Cyclical

These digital businesses are only one reason why Redfin’s overall gross margins improved from 30% in the third quarter of 2022, to 37% in the third quarter of 2023. Within real estate services over that time, gross margins improved from 26% to 30%. Just as important, Redfin has made ourselves less sensitive to housing’s ups and downs. Even as we’ve developed one digital revenue stream after another, we’ve gotten out of a business that involved holding hundreds of millions of dollars in houses, and launched a pilot eliminating agent salaries.

Question Everything Except Our Fighting Mettle

While some of our rivals have made a virtue of spending, Redfin is proud of how quickly and thoroughly we’ve restructured ourselves to be faster, more efficient and more competitive. Few companies that have gone through that process have wanted to go back. The downturn has made us stronger.

Redfin Will Become More Digital Over Time, But Never Completely Digital

Redfin will become more digital over time, but only where it makes sense: where our own employees can serve our audience better, with more profits, we will. We believe having that flexibility, when many businesses are either completely reliant on partners or handle virtually every customer themselves, will make us more profitable over time.

Redfin.com Traffic Surpasses 2022 for the First Time All Year

And we’ll have more opportunities to earn money from our audience as that audience grows. Comparing the third quarters of 2022 and 2023, visitors to Redfin.com grew by one percent. This was the first year-over-year gain in 2023. This gain has been the result of our increasing ability to compete for traffic against our two historical rivals, Zillow and Realtor.com. According to Comscore data, the gap in year-over-year visitor growth between Redfin and these sites averaged 11 points in the third quarter.

Redfin.com Grows Despite Massive Competitor’s Major Ad Campaign

We’ll continue measuring our progress against our longtime rivals, but have also begun monitoring traffic to CoStar’s Homes.com, which has benefited from a major ad campaign since the second quarter of 2023. That Redfin’s growth came in the face of this campaign, and with U.S. home sales still falling, makes it all the more impressive.

Why We Keep Gaining: Better Search

We attribute our success to a better search experience. We’re still drawing more visitors from search-engines like Google, and still improving the listing recommendations that keep visitors coming
back for more, but the most fundamental improvement may be in how we present search results, in a feed that combines listings with market news and agent insights.

Rent Breaks Into the Black
This growth in Redfin’s audience, especially among people looking at rental properties, is only one reason Rent earned its first quarterly profit since Redfin acquired Rent in April 2021. The revenue booked per sales person has increased 362% since the third quarter of 2021, when Rent’s new leader came on board. In the third quarter of 2023, revenues increased 23% year-over-year, the fourth straight quarter of growth, after years of declines. Rent’s third-quarter net bookings, which are the annualized revenues added through sales to new customers less the annualized revenues lost from departing customers, grew 51% year over year.

Most Revenue Growth Should Come From our High-Margin Marketplace
We expect Rent’s growth to continue, especially in its core online marketplace for connecting potential tenants to properties. We’re also driving sales from an expanded line of digital-marketing solutions, for promoting our customers’ apartment buildings on search engines and social-media sites; unmatched by our largest rentals competitors, these products help us open new accounts with customers who are trying to reduce the number of specialized marketing vendors that they pay.

Rent Traffic-Driving Initiatives Should Let Us Support More Marketplace Customers
To keep growing our marketplace, our focus will be on generating more traffic and tenant inquiries. After a year of rebranding as Rent and unifying the code base for Rent.com and ApartmentGuide.com, Rent is now able to invest in tried-and-true demand-driving tactics: email campaigns, improvements in our mobile applications’ user experience, efficiency gains in search-engine marketing, and machine-learning-based software for engaging visitors. This is why we’re optimistic that Rent’s growth will continue.

Real Estate Services Goes on the Attack

Redfin Max: The Best of Both Worlds
Even as we gain strength in our digital businesses, we’re also reducing fixed costs in our core business of brokering home sales. We’ve begun hiring Redfin agents in San Francisco and Los Angeles on the promise of a new, all-variable compensation plan, which takes effect January 1. The goal of this new pay plan, which we’re calling Redfin Max, is to offer agents the best of both worlds. On self-sourced sales, our agents will keep as much as 75% of the commission, which compares favorably with what many traditional brokers pay. But unlike many traditional brokers, Redfin will also offer agents the support staff and customer introductions to build a larger business.
Retaining and Recruiting the Best Agents Will Lead to More Redfin-Sourced Sales

We’re not aiming to make much money on agents’ self-sourced sales, as few traditional brokers have ever earned a decent margin; our goal is to recruit agents who can close Redfin-sourced sales at a high rate. The margins on Redfin-sourced sales should remain well above those of other brokers. Even if Max agents’ sales turn out to be largely self-sourced, lowering margins on a larger volume of sales in our pilot markets, the impact on Redfin’s overall gross margin will be negligible. We won’t extend Redfin Max to a large number of markets unless we become convinced that it will net more gross profits. For Max to succeed, a new cohort of motivated, high-caliber agents has to close only a few more sales each year than we normally would with the same set of site-sourced opportunities.

Employees Are More Productive at Closing Online Inquiries, Redfin Is More Resilient

This is a bold change, but not as bold as it could have been. The Redfin Max plan still employs our agents, because we know from experience with online inquiries how important it is to take a team-based, systematic approach with customers who want immediate service from an agent assigned to them by our site. Employing agents also lets us ensure the agent puts the customer first. But all-variable pay should let us hire more agents in Max markets, so we can bet more on growth with less at risk for Redfin through a downturn.

Already, We’ve Recruited Six Max Agents

The reception so far to Redfin Max has been good. From October 16, when recruiters first got the Max materials, through October 31, six agents already agreed to join us. Candidates we’d been courting for months signed on, almost on the spot, saying this plan made the decision easy. Several agents who long ago left Redfin contacted me the week of the launch to ask about coming back. Our goal is to add about 60 top-producing agents in San Francisco and LA.

A New Day in Our Brokerage

Redfin Max is one of several big changes afoot at our brokerage. We began developing several others the week of September 10, when Jason Aleem assumed sole responsibility for our brokerage. For example, we’re now testing incentives for customers who buy a Redfin listing, or who commit to hiring a Redfin agent early in their home search. We’re overturning our most intricate systems for scheduling tours and assigning customers, to ensure our best sales people host our first meeting with a customer, when before we’d scheduled those tours with contractors. Already, this has led to a double-digit increase in the percentage of customers who are still meeting the contractors we call on for back-up property access.

In a More Volatile, Competitive Market, A Shift Toward Speed and Simplicity

We’ll keep you posted on whether Redfin Max agents can succeed in our system, or if our other new initiatives drive sales. What investors should know now is that our brokerage is moving fast and simplifying its policies. The more analytical approach we’ve had in the past let us optimize the sales tactics of a large sales force in a stable market. But in a more volatile, competitive market, filled with solo
Title Forward Growing Despite Headwinds, Bay Equity Attach Rates Mostly Flat

As our brokerage gains market-share, we’ll also get more title and mortgage sales. The attach rate for our title business increased from 39% in the third quarter of 2022 to 57% in the third quarter of 2023. Eighteen percent of our brokerage’s third-quarter homebuyers used Bay Equity for a mortgage, up from 17% in the third quarter of 2022. In the second quarter of 2023, Bay Equity’s attach rate was 19%. Both Bay Equity and Title Forward remain vigilant about costs, having laid off employees in October to improve profits in a falling housing market.

Goal Over Time: 25% - 30% Lending Attach Rate

As we said in our last earnings call, we expect that lifting lending attach rates much above 15% will take time, especially when the proportion of all-cash buyers is rising in step with interest rates. But we believe a long-term attach-rate goal of between 25% and 30% is still realistic. We’re now experimenting with new incentives for managers and, where the law allows, for agents.

An Important Long-Term Source of Profits

The investment we’ve made in handling every aspect of a customer’s move isn’t paying off now because no one in the lending industry is making much money. But when rates ease, whether in 2024 or beyond, Bay Equity’s gains on sale will likely increase, easing price pressure may lead to higher brokerage attach rates, and our refinancing business will boom.

A Changing Real Estate Industry: Redfin Is On the Right Side of History

Before turning to the housing market, let’s discuss the $1.8-billion verdict in the federal class-action lawsuit in Missouri against the National Association of Realtors and several major brokers. This is an outcome that Redfin has long prepared for: from the day years ago that we launched a brokerage to give consumers a better deal, up to last month, when we were the first major real estate company to announce our break with the National Association of Realtors.

In an Industry Facing Costly Litigation and Reform, Redfin Has Been Ready

The Missouri verdict may lead to reforms in how agents talk to listing customers about the fees offered to buyers’ agents. The litigation has already led the National Association of Realtors to change its guidelines to local Multiple Listing Services, which will now accept listings that don’t offer a commission to buyers’ agents. Redfin has long counseled our agents to support any fee a listing customer wants to pay a buyer’s agent. Alone among major brokerages, we exist to charge customers lower fees.
Ready for a Revolution Too

But the Missouri verdict and other court cases may lead to a revolution in our industry, not just reform. If buyers’ agents become less common, Redfin will prosper in that world too. We run the largest brokerage website in America, as well as a national network of contractors trained and licensed to provide low-cost, on-demand property access. We’ve built self-service technology for buyers to set up their own tours and to make offers on our listings without a buyer’s agent. We can use that technology to market the properties listed by our agents directly to consumers, taking market share from other brokerages. And we may open that platform to other listing agents who work with us as partners. We’ve sometimes been ahead of our time; if a massive disruption is at hand, we aren’t going to fall behind now.

The Housing Market: Near Rock Bottom

With that said, let’s discuss the housing market. Goldman Sachs last week forecasted existing home sales will fall further, from 4.1 million units in 2023 to 3.8 million in 2024, a level not reached since 1993, when the U.S. population was 22% smaller. U.S. gross domestic product grew at a blistering 4.9% in the third quarter of 2023, keeping the pressure on the Federal Reserve to hold interest rates higher for longer, even as war, political gridlock and sovereign debt have put the global economy on a knife’s edge.

There Will Always Be a Market for Housing

But now like Satan in Paradise Lost, surveying the dismal expanse of rocks, caves, lakes, fens, bogs, and dens of his new home in hell, I feel a twinge of optimism. If homes were only a speculative asset, our sales prospects would indeed be grim, but most people buy a home to move to a better life. Those plans can be deferred from 2022 to 2023, but not forever.

A Welcome Break From Rising Home Prices

The number of people asking for listing consultations increased meaningfully in the closing weeks of October, as part of an overall year-over-year increase in customers contacting Redfin agents. For the first time in years, we see signs that home prices may soften, a welcome development for home sales and for America when affordability has been at a four-decade low. Owners always mark listings down that didn’t sell in the summer, but there are more price drops this fall since at least 2015.

Full-Year Projections Are a Crapshoot. We’ll Run Redfin from Quarter to Quarter

We know from our experience building Redfin through the multi-year Great Financial Crisis how false starts can break your heart. In such a volatile market, any full-year projection, even from Goldman Sachs, is mostly just gizzard-squeezing guesswork. For now, we have to assume that next year will start like this one is ending, with a whimper. Chris and I will run Redfin from quarter to quarter, rejecting most discretionary expenses until the housing market improves.
A Special Focus on Keeping Costs Low in the First Quarter

This will be especially true in the first quarter, which in most of Redfin’s loss-making years has accounted for nearly our entire loss. In the past, we’ve made investments in the first quarter based on the number of sales we expect to close in the third quarter. But in 2024, we’ll defer many of those expenses until we can see if any rate relief is likely to come in time for the summer homebuying season. We can’t entirely avoid a seasonal first-quarter loss, but minimizing it will give us more ways to win through the rest of the year.

100% PURE GRAPE NUTS

As we’ve planned for 2024, a phrase from my youth has often come back to me. When we both were just graduating from college, my identical twin brother broke his leg very badly. In the hospital, he was all sweat, skin and bones. Since he couldn’t go to the store himself, my contribution to his recovery was a low-fat regimen of muscle-building Grape Nuts cereal. During his physical-therapy sessions, I’d yell, “100% PURE GRAPE NUTS.” The science was dubious, but ever since, he has been able to run a mile faster than I can. Redfin has suffered its own setbacks, but now we’re running faster than ever before. Hardly a day goes by that I don’t say to myself: 100% PURE GRAPE NUTS. Take it away Chris!

CFO Section

Thanks, Glenn!

While the housing market is undeniably challenging, Redfin is delivering solid financial results. Third-quarter revenue was $269 million, down 12% from a year ago. At the same time, gross profit of $98 million was up 8% year-over-year and total gross margins expanded from 30% to 37%. We also posted $8 million of adjusted EBITDA for the quarter, up from a loss of $12 million from continuing operations in the prior year. This improvement in profitability is the direct result of actions we’ve taken over the last year to align the business with changing market conditions. We are not out of the woods yet, but we are highly encouraged by the momentum we are seeing in top-of-funnel as well as sequential market share gains this quarter. We’ll continue to make thoughtful choices to position the business for profitability while being ready for when the market rebounds.

Turning to our segment results, real estate services revenue, which includes our brokerage and partner businesses, generated $178 million in revenue, down 16% year-over-year. Brokerage revenue, or revenue from home sales closed by our own agents, was down 18%, on a 28% decrease in brokerage transactions offset by a 14% increase in brokerage revenue per transaction. The increase in revenue per transaction was driven by the elimination of our homebuyer commission refund, revenue from concierge renovations and a 4% increase in average home prices for brokerage transactions. Revenue from our partners increased 30%, on a 24% increase in transactions and mix shift to higher value houses.
Real estate services gross margin was 30.4%, up 440 basis points year-over-year. This was primarily driven by a 510 basis-point decrease in personnel costs and transaction bonuses and a 160 basis-point decrease in tour and field expenses, offset by a 190 basis-point increase in seller home improvement expenses. Total net loss for real estate services in the third quarter was $1 million, up from a net loss of $10 million in the prior year, and adjusted EBITDA was $13 million, up from $4 million in the prior year. The increase was attributable to higher gross margins and lower operating expenses, which more than offset lower revenues.

Our rentals segment posted its fourth straight quarter of growth, with revenue of $47 million and growth of 23%. Total net loss for rentals was $13 million, up from a net loss of $20 million in the prior year. Adjusted EBITDA for the third quarter was about $600 thousand. We’d previously said that we expected our rentals business to generate positive adjusted EBITDA by the fourth quarter of 2023, and we’re pleased to hit this milestone in the third quarter.

Our mortgage segment generated $33 million in revenue, down 32% year-over-year. This result was slightly below our guidance range, as higher interest rates negatively impacted consumer demand for loans. Mortgage gross margin was 10.0%, up from 9.7% a year ago. Net loss for mortgage was $5 million, which was roughly flat compared to the prior year. Adjusted EBITDA loss was $4 million, compared to a $3 million loss in the prior year.

Our other segment generated revenue of $11 million, compared to $7 million in the prior year, as both our title and digital revenue businesses grew. Other segment gross margin was 40.4%, up from 15.0% a year ago. Total net income was $2 million compared to a small net loss in the prior year, and adjusted EBITDA was positive $3 million compared to flat in the prior year.

Turning back to consolidated results, total operating expenses were $124 million, down $11 million year-over-year for our continuing operations. The decrease was primarily attributable to $9 million in lower marketing expenses and $2 million in lower personnel expenses.

Net loss was $19 million, compared to a net loss from continuing operations of $46 million in the prior year, or $90 million including discontinued operations. This was better than our $30 million to $21 million loss guidance range due to a $6 million gain on the extinguishment of notes, none of which was anticipated in our guidance. Our adjusted EBITDA from continuing operations was $8 million, in-line with our guidance range of $4 million to $14 million.

Diluted loss per share from continuing operations attributable to common stock was $0.17, compared with $0.43 one year ago.

Now turning to our financial expectations for the fourth quarter as well as our longer range profitability targets:
To begin, I wanted to note that at the end of October we closed on a $250 million term loan facility which gives us flexibility going into what continues to be an uncertain year for the housing market. We now have more than enough cash and liquidity to cover our debt maturities for the next three years, which also gives ample time to generate cash to address later dated maturities. Our expectations for the fourth quarter have come down since our August earnings call, with higher interest rates weighing on transaction volumes. Even so, we are still working towards our goal to achieve adjusted EBITDA breakeven on a trailing-twelve-month basis in the first half of 2024. Our second profitability target, which was to be net income positive in 2024, may not be achievable given the higher interest expense we expect on our term loan facility, but we’ll still expect to see a meaningful improvement in net income in 2024 compared to 2023.

Our guidance for the fourth quarter of 2023 reflects stabilizing revenues, with total revenue from continuing operations declining just 5% on the low end and growing 2% on the high end. Real estate services revenues are expected to decline between 13% and 6%, though we expect total gross profit for the segment to grow year-over-year with gross margins expanding 200 to 500 basis points compared to the fourth quarter of 2022. Rentals revenue is expected to continue to grow, with year-over-year growth between 19% and 22%. Mortgage revenue is expected to decline 8% on the low end and grow 2% on the high end. Finally, other segment revenue is expected to grow between 49% and 55%.

Total net loss is expected to be between $27 million and $18 million, compared to net loss of $62 million in the fourth quarter of 2022. This guidance includes approximately $27 million in gains on the extinguishment of notes, which are included in net loss but excluded from adjusted EBITDA. These gains are associated with the notes repurchased from Apollo as disclosed in the 8-K we issued.

Adjusted EBITDA loss from continuing operations is expected to be between $19 million and $9 million, which at the high end would be an improvement of more than $30 million compared to Q4 2022 continuing operations, or an improvement of $55 million including the prior year loss from discontinued operations.

As Glenn noted in his remarks, the housing market is near rock bottom, but we believe our Q3 results and Q4 outlook demonstrate our ability to manage the business along the path to profitability in spite of the challenging market, and we believe improvements we’re making to enhance both profitability and resilience will benefit the business for years to come.

And now let’s take your questions!