Q2 2022 Prepared Remarks

Good afternoon and welcome to Redfin’s financial results conference call for the second quarter ended June 30, 2022.

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.

**A Weakening Market, A Strengthening Company**

Thanks Meg, and hello everyone. Redfin in the second quarter performed below the expectations we set in our last call, with revenue of $607 million compared to a projection of $613 million - $650 million. The shortfall was due to the largest rate hike in 35 years, which in June curtailed the second-quarter lending revenues of Bay Equity, the lender we acquired in April, by $15 million. Our net income was nonetheless in line with expectations after the exclusion of $10 million in restructuring costs for the 6% of our employees we laid off in June. The adjusted EBITDA loss was $29 million.
Redfin Broadens Its Reach

In five years as a public company, Redfin has never before fallen short of our revenue projections. But this is also true: that even as the housing market weakened our results, Redfin has gotten stronger. We expanded our site from 91% of the homes in America to 94%, to compete as a national rather than a regional destination. Our year-over-year brokerage share gains once again began to accelerate, from four basis points in the first quarter to five basis points in the second quarter.

Improving Sales Execution

We hired agents too quickly during the pandemic, but now sales execution is improving across the board. Of the Redfin customers who bought a home, a higher percentage stuck with us for that purchase, the first such gain since April 2020. The percentage of Redfin homebuyers who got a Redfin mortgage increased to 11% in June and 15% in July, which is nearly double the five-year monthly high of 8% that we’d reached prior to acquiring Bay Equity Home Loans. Title Forward’s second-quarter attach rate also more than doubled, from 12% in 2021 to 32% in 2022.

Ads Promoting 1% Fee Drive Listing Share

We’ve learned where low fees let us take share, and where we can raise prices to increase profits. In the markets where we came back to advertising the 1% listing fee we charge our move-up customers, new Redfin listings in July grew ten points faster than the market overall; in the month prior to the campaign’s launch, new Redfin listings were growing more slowly than the market. As we invest more in advertising this fee in 2023, we expect listing market share to accelerate.

Eliminating the Refund May Significantly Improve Margins

But we’ll likely stop trying to convince buyers they should save money on their own agent, since buyers aren’t the ones who pay that agent directly. On July 26, we eliminated the commission refund we offered homebuyers in 22 markets, with few objections from customers or agents. If this pilot continues to be successful, we’ll eliminate the refund entirely as early as January 2023, improving full-year gross margins in our core business by more than five hundred basis points. In the nine small markets that already eliminated the refund in 2019, we kept taking share. Our mission to put customers first is stronger than ever, but we need to save customers money at the points in the moving process when money matters the most: when choosing which listing agent to hire, and when shopping for mortgage rates.

We’ll Run the Business Out of the Cash Register

This pricing decision is one of thousands that Redfin is making to become profitable, as this market correction has forced us to simplify our business. Our goal isn’t just to survive the downturn, but to come out of it stronger.
Traffic Growth Slowing

Profit discipline and sales execution have become more important to Redfin with housing demand weakening. As affordability pressure began to mount in February, more people searched Google for rental homes than real estate, favoring sites like Zillow with well-established rentals search. Redfin is still competing effectively for new visitors searching online for homes for sale, but our visitors have become less likely to return, with some suspending their home search until the economy improves.

Rentals Traffic Growing 9% per Month

The shift in interest toward rentals slowed traffic growth to Redfin.com and Redfin’s mobile applications from 11% year-over-year in the first quarter, to 9% in the second. Over time, Redfin expects to compete better for renters, not just home-buyers. Since adding rental listings to Redfin.com at the end of March, visits to rental listings on Redfin.com and Redfin mobile applications have grown at a monthly rate of 9%, and the number of inquiries Redfin.com sent to our property-management customers have grown even faster. Already, Redfin.com accounts for 4% of the rental inquiries generated by all of our rental-search sites.

RentPath Grows Quarter over Quarter for the First Time Since 2017

That Redfin.com contribution is just one reason that RentPath, the rentals marketplace we acquired out of bankruptcy in April 2021, recorded its first quarter-on-quarter revenue growth since 2017. Total rentals site visits, including rental traffic on Redfin.com, are up 9% year-over-year. While we still need to improve customer retention, second-quarter bookings are up 24% year over year; since July 2021, the productivity of sales people at generating new bookings has doubled. At the June National Apartment Association conference, RentPath re-launched as Rent, anointing Rent.com as our flagship site rather than ApartmentGuide, and simplifying the story of how our marketing services and online marketplaces work together.

Redfin.com Awareness Growing

As Rent recruits more property managers to promote their apartment buildings on our network of sites, we’ll compete more effectively with the largest real estate portals. Our goal is to surpass Realtor.com, now second only to Zillow in real estate traffic. Already among people looking to buy or sell a home in the 20-largest U.S. markets, 30% in the second quarter named Redfin as one of the first three real estate sites to come to mind, compared to 23% for Realtor.com. At the beginning of 2021, these numbers were reversed. Becoming one of North America’s top-two real estate search sites can have a seismic impact on demand, accelerating brokerage share gains.
The Brokerage as an Engine of Growth

And we can invest more in driving demand as we improve monetization. This is where Redfin has made the most progress over the last three months, first by eliminating our commission refund in the 22-market pilot, second by increasing the rate at which the Redfin customers who buy homes stick with a Redfin agent for the purchase.

Balancing Supply and Demand

The buyer pull-back from the market downturn left many of our agents idle, swinging real estate services to a second-quarter adjusted EBITDA loss. But we reduced costs within the quarter, lowering expenses quickly while holding onto the people needed for long-term growth. This June 14 layoff may be a setback for near-term gains in share and close-rate, but not over time: the agents who stayed had a close rate nearly double that of the agents who left. Even if the buyers now returning to the market will take time to close, our agents’ sales pipelines are now mostly full.

Loyalty Sales Outpacing Sales From Our Site

Another improving measure of agent performance is loyalty sales. The fraction of our brokerage sales that come from past clients, client referrals or through agents’ personal networks had already increased from 24% in 2019, to 27% in 2020, to 32% in 2021. But in the second quarter of 2022, it rose even higher, to 35%. Outside of our layoff, agent attrition has also improved, falling by five points from the second quarter of 2021 to the second quarter of 2022. This is why we expect loyalty sales to keep outpacing sales from our site, especially as we offer more incentives for top-performing agents.

The Bay Equity Acquisition Has Doubled Attach Rates

Redfin employs many of the agents we recommend on our site because we believe those agents deliver better service. But employing agents also gives us the standing to ask those agents to sell Redfin’s suite of lending, title and renovation services. It’s why we could double the rate at which Redfin homebuyers get a Redfin mortgage, though we’ve only owned Bay Equity since April 1.

Short-Term Margin Pressure, Significant Long-Term Gains in Profit per Customer

Our success in Atlanta and Salt Lake City, where 34% of homebuyers got a Bay Equity mortgage in July, tells us that Redfin’s overall attach rate of 15% is just the beginning. Over time, we also expect significant margin expansion on our loans. When we announced the acquisition, we told investors that Bay Equity and Redfin earned a similar amount of gross profit per homebuyer in 2021, as a tribute to Bay Equity’s underwriting efficiency.
As Rate Pressure Recedes, Margins Will Rise

Since then, a massive contraction in mortgage lending has led many lenders to issue mortgages at a loss, forcing Bay Equity to cut its gross profit per loan in half. Bay Equity already reduced staffing on July 28. When rates stabilize and Bay Equity can raise prices on new loans, and also refinance many of our 2022 loans, we’ll have the potential to generate more profit from a customer than any other broker. This acquisition can change the fundamental physics of our business.

Redfin Can Help Bay Equity Grow Its Traditional Business Too

Redfin has been a new source of sales for Bay Equity, but also a recruiting partner for building Bay Equity’s traditional business, of meeting homebuyers through agents at other brokerages. In market after market, from Washington DC to Seattle to Chicago, Bay Equity has recruited loan officers who once got plenty of loans from Redfin agents while working at competitors, but then saw that volume dwindle after our acquisition. Joining Bay Equity, a loan officer gets a steady source of referrals from Redfin agents, but also brings over other customers and agent partners outside the Redfin network.

RedfinNow Weathers a Major Market Downturn

Beyond mortgage, the business most affected by market forces is RedfinNow, which gives home-owners an immediate cash offer. Our properties segment earned $6.8 million in second-quarter gross profit, up from $5.0 million in the second quarter of last year. But because of a sharp decline in U.S. home-buying demand, we now expect to sell the homes we agreed to buy in April and May for a loss after accounting for holding costs, selling costs and repairs. That won’t be enough to sink our battleship. Our forecast assumes home prices keep declining moderately through the rest of 2022, but we still expect our properties division to earn a significant gross profit for the full year.

RedfinNow Lowered Offers Significantly in May

We aren’t worried about the homes we agreed to buy in June or July, because we haven’t bought as many, or paid as much for those homes. In April and May, RedfinNow’s offer amounts were based on the assumption that home prices would hold steady over the four months that it typically takes us to clear out the original owner, to get the home on the market, and to get the next owner under contract. In June and July, RedfinNow assumed home prices would decline about 6% over that time.

Inventory Declining from Early August Through Year End

We’re now selling homes much more quickly than we are buying them. In July we put more than four homes under contract to sell for every one we put under contract to buy. Our inventory should peak early next week at $436 million in homes owned, and then decline quickly. We expect that virtually all of
the homes we bid on in the spring will be under contract to the ultimate buyer by October, and off our books by year-end.

**Vindication for RedfinNow Can Only Come After a Correction**

We have long believed that homeowners’ interest in immediate liquidity is here to stay, but that we wouldn’t know iBuying’s true margins until we weathered a downturn that lasted longer than the false starts of late 2018 and mid 2020. We’ve also believed that iBuying is only worthwhile as part of a brokerage that can serve homeowners even when market conditions make iBuying nearly cost-prohibitive. That latter belief has already been vindicated. For every RedfinNow inquiry that led to an accepted offer in June, two more led to the homeowner hiring a Redfin agent to list the home instead.

**How It All Fits Together: Drive Share Or You’re Out of There**

Driving brokerage share is the rationale not just for RedfinNow, but for every one of Redfin’s businesses. We invested in rentals because becoming one of the Internet’s top real-estate destinations is crucial to our share growth. We built a title business and bought a lender because employing agents lets us sell a suite of services better than any other broker; every extra dollar that these businesses earn from a customer can be reinvested in driving more brokerage demand or can be returned to investors. After all, we’re too small and too mission-driven to be a holding company for housing-related business. We tell ourselves that if a business doesn’t drive brokerage share, it’s out of there.

**The Profits Start Adding Up in 2023**

But though each of these businesses shares the same market-share goal, we’ve presented the profits of each separately, to clarify the scope of our investment in each. Our plan to generate our first annual net income in 2024 entails generating adjusted EBITDA in 2023; only one of our major businesses, rentals, can lose a significant amount of money next year. Our brokerage generated profits in 2021, and Bay Equity had been profitable for almost its entire 16-year history prior to this summer’s rate hike, so both can return to profits when the market settles down. We expect the remainder of our businesses will be near break-even in 2023.

**The Housing Market: Sharp June Drop, Green July Shoots**

Before turning the call over to Chris, let’s discuss the housing market, which got significantly worse in June, but then improved in July. The breaking point for many buyers came on Friday, June 10, when mortgage rates spiked 30 basis points, and climbed another 43 basis points to 6.28% the following Monday and Tuesday, for the biggest one-week jump since 1987.
From May to June, Sales Dropped 9%

From June 2021 to June 2022, pending home sales dropped 20%. Just from May 2022 to June 2022, the drop was a whopping 9%, when economists expected it to be 1%. Existing home sales may dip below an annualized rate of 5-million units, a Mendoza line for housing that we haven’t breached for a full year since 2014.

Percentage of Homes with Price Drop Doubles

The percentage of homes that had a price drop in June doubled, from 9% in 2021 to 18% in 2022, a trend that we expect to accelerate when the dust settles on July numbers. In pandemic markets like Denver, more than half of all listings had a price reduction. In Boise, that number was 62%.

Price Drops Probably Larger Than Reported

From March to mid-July, year-over-year price-growth slowed from 16% to 9%, but the value of most homes probably fell further. The reported numbers reflect sales prices only for homes that sold, when we know the market has become more selective: beautiful homes on corner lots still sell readily, but the homes with funky layouts now don’t sell at all. In lieu of publicly reported price drops, builders are funding lower mortgage rates, paying closing costs, doubling agent commissions, buying washers and dryers, and upgrading kitchen finishes.

The Correction May Be Sharper But Also Shorter

One reason prices are falling fast is the fraction of inventory now being sold by iBuyers, builders and other institutions, which has increased from about 27% in 2017 to nearly 35% in 2022. Redfin knows from our experience as a broker that people who’ve lived their whole lives in a home just aren’t going to mark it down after a few weeks. But iBuyers price the listing below every current comparable, and price it even lower if it doesn’t get an offer in the opening weekend; builders also respond to market downturns quickly. This makes market corrections sharper, but maybe also shorter too.

Buyer Demand Improved Modestly Mid-July

The good news is that buyers are already responding to drops in prices and mortgage rates. The market-wide data on sales closed in July and August will reflect how far demand fell in June but now demand has modestly improved in the second, third and fourth weeks of July. It may improve further, as mortgage rates dropped this week to around 5% from a peak north of 6% in June. If the housing market and the overall economy can stabilize, many, many Americans still want to move, and we’re here to help ‘em, with low fees and the best service in the brokerage industry. Take it away Chris!
CFO Section

Thanks, Glenn!

This was a volatile quarter, and we’re being responsive to the changing macro environment and taking actions to manage towards profitability, including reducing the number of homes we purchase through our properties segment, laying off employees in our headquarters, real estate services and mortgage businesses, and limiting backfills for voluntary attrition.

Second-quarter revenue was $607 million, up 29% from a year ago and below the low end of our $613 million to $650 million guidance range. The difference was due to a quicker than anticipated decline in refinancing and purchase-home volumes for Bay Equity.

Real estate services revenue, which includes our brokerage and partner businesses, generated $252 million in revenue, which was flat year-over-year and in-line with guidance. Brokerage revenue, or revenue from home sales closed by our own agents, was up 1%, driven by home price appreciation, while transaction volume was down 2%. Revenue from our partners was down 23%, on a 13% decrease in transactions and mix shift to lower value houses. Overall real estate services revenue per transaction was up 4% year-over-year.

The properties segment, which consists primarily of homes sold through RedfinNow, generated $263 million in revenue, up 52% from a year ago and driven by a 45% increase in homes sold.

Our rentals business generated $38 million, down 10% from a year ago but up slightly from the first quarter of 2022. As Glenn mentioned, this marks the first quarter of sequential revenue growth for this business in many years.

Our mortgage segment generated $53 million in revenue in the second quarter. This was below our guidance range as discussed above, but we’re thrilled with how Bay Equity loan officers have been serving Redfin customers.

Our other segment, which now includes title, and other services, contributed revenue of $6 million, an increase of 72% year-over-year, driven by increased attach rates for our title and closing services.

Total gross profit was $118 million, down 6% year-over-year, with a total gross margin of 19.4%.

Total operating expenses were up $36.2 million, or 23% year-over-year. $23.6 million of the increase was attributable to the acquisition of Bay Equity, our mortgage business, as well as restructuring expenses incurred in the quarter. As a percentage of revenue, total operating expenses represented 32%, down from 33% one year ago.
Technology and development expenses increased by $10.0 million, or 24% year-over-year. Included in the increase was $0.7 million from Bay Equity. The remaining increase was primarily attributable to an $8.7 million increase in personnel costs due to increased headcount. Total technology and development expenses represented 8% of revenue, down from 9% one year ago.

Marketing expenses increased by $1.3 million, as compared with the same period in 2021. Included in the increase was $1.8 million from Bay Equity. The remaining decrease was primarily attributable to a $1.9 million decrease in outside services and recruiting, offset by a $1.5 million increase in personnel costs. Total marketing expenses represented 9% of revenue, down from 12% one year ago.

General and administrative expenses increased by $12.2 million, or 20%, as compared with the same period in 2021. Included in the increase was a $8.4 million from Bay Equity, a $3.2 million increase in legal expenses, largely due to a settlement offer, and a $3.1 million increase in personnel costs due to increased headcount. This was partially offset by a $4.2 million decrease in acquisition-related expenses. Total G&A expenses represented 12% of revenue, down from 13% one year ago.

Restructuring expenses included in total operating expenses were $12.7 million, and there were no such expenses in the same period in 2021. These expenses were attributable to $2.4 million in severance and other costs associated with our mortgage restructuring, and $10.3 million in severance costs associated with our June 2022 workforce reduction.

Turning to segment level profitability, real estate services gross margin was 29.4%, down 550 basis points year-over-year. This was driven by a 670 basis point increase in personnel costs and transaction bonuses. This increase was offset by a 210 basis-point decrease in tour and field costs and 50 basis-point decrease in listing expenses. Total net loss for real estate services was $18.8 million, down from net income of $7.8 million in the prior year. The decrease was attributable to lower revenue and margins, as well as a $12.5 million year-over-year increase in operating expenses. These expenses were added during a period of rapid growth in our real estate services business, and we have begun to pare back with the restructuring announced in June.

Properties gross margin was 2.6%, down 30 basis points year-over-year. This was driven by an 80 basis-point increase in purchase, maintenance and capital improvement costs. This was partially offset by a 50 basis-point decrease in personnel costs as the business scaled. Total net loss for properties was $3.2 million, down from a net loss of $1.4 million in the prior year, with the increase in operating expenses slightly exceeding the increase in gross profits.

Rentals gross margin was 79.3%, down 290 basis points year-over-year. This was driven by a 180 basis-point increase in personnel costs, as we sold more marketing services that require personnel to fulfill. Total net loss for rentals was $19.2 million, down from a net loss of $14.1 million. Declining profitability was primarily attributable to year-over-year declines in revenue, as discussed earlier, while operating expenses remained roughly flat at $49.8 million compared to $49.3 million in the prior year.
Mortgage gross margin was 12.8% for the second quarter, below our implied guidance of 31% to 36%. This was driven by lower refinancing and purchase volume from Bay Equity’s historic business. Total net loss for mortgage was $6.5 million. We acquired Bay Equity on April 1 of this year, and completed the wind down of our legacy mortgage business during the second quarter of 2022. Wind down activities contributed approximately $4.9 million to the segment’s net loss; $1.6 million is attributable to Bay Equity.

Other segment gross margin was negative 0.1%, an improvement from negative 6.1% a year ago. Total net loss was $2.1 million compared to a net loss of $1.1 million in the prior year.

Turning back to consolidated results, total net loss of $78 million was below the low end of our $72 million to $60 million guidance range. Our guidance didn’t include $10.3 million of restructuring expenses, for our June layoff.

Diluted loss per share attributable to common stock was $0.73, compared with diluted loss per share attributable to common stock of $0.29 per share one year ago.

Now turning to our financial expectations for the third quarter of 2022:

Consolidated revenue is expected to be between $590 million and $627 million, representing year-over-year growth between 9% and 16%. We expect our real estate services segment to account for $200 million to $208 million of that revenue, and the properties segment to be between $305 million and $330 million. Rentals revenue is expected to be between $37 million and $38 million. Mortgage revenue is expected to be between $45 million and $48 million.

Total net loss is expected to be between $87 million and $79 million compared to total net loss of $19 million in the prior year. Adjusted EBITDA loss is expected to be between $47 million and $39 million.

We expect real estate services gross margin to decrease in the third quarter compared with the same period in 2021. In prior earnings calls we’d discussed operational changes we were making that were intended to increase real estate service gross margins in the second half of 2022. However, deteriorating macroeconomic conditions have overshadowed these operational changes and we now expect margin compression.

With respect to properties, we expect gross margins to be negative in the third quarter as we work through selling inventory that was purchased earlier this year. We expect inventory to peak in August. We want to continue to offer a choice to consumers, but we’re being more conservative on offer prices.

With respect to mortgage, we expect gross margins to be roughly flat to slightly down quarter over quarter.
On a consolidated basis, this guidance includes approximately $37 million in total company marketing expense, $19 million of stock-based compensation, $16 million of depreciation and amortization, and $5 million of interest expense. In addition, we expect to pay a quarterly dividend of 30,640 shares of common stock to our preferred stockholder.

This guidance 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, let's take your questions!