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PRESENTATION

Operator

Greetings, and welcome to Redfin Corporation's Third Quarter 2023 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Meg Nunnally. Thank you. You may begin.

Meg Nunnally *- Redfin Corporation - Head of IR*

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 related 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 also be available soon after the call.

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

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

Thanks, Meg. 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.

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.

The share of home sales brokered by our own agents and through referrals to our partner agents also increased, from 0.75% in the second quarter of 2023 to 0.78% 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.

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. 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.

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. 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.

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.

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.

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 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.

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.

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.

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.

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.

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.

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: e-mail campaigns, improvements in our mobile applications' user experience, efficiency gains in search-engine marketing, and machinelearning-based software for engaging visitors. This is why we're optimistic that Rent's growth will continue.

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 LA on the promise of a new, all-variable compensation plan, which takes effect January 1st. 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.

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.

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.

The reception so far to Redfin Max has been good. From October 16, when recruiters first got the Max materials, through October 31, 6 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.

Redfin Max is one of several big changes afoot at our brokerage. We began developing several others the week of September 10th, 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 met on their first tour by our sales people; the remainder are still meeting the contractors we call on for back-up property access.

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 practitioners who can turn on a dime, we're taking more risk to go on the attack. The speed and scale of these initiatives would've been unimaginable in prior years.

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. 18% 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.

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.

The investment we've made in handling every aspect of a customer's move, those investments aren'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.

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.

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.

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 in fact at hand, we aren't going to fall behind now.

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.

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.

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.

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.

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.

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.

Christopher Nielsen - *Redfin Corporation - CFO*

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 a 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 $600,000. Weâ€™d previously said that we expected our rentals business to generate positive adjusted EBITDA by the fourth quarter of 2023, and weâ€™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 $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 12-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 weâ€™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.

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 weâ€™re making to enhance both profitability and resilience will benefit the business for years to come.

And now letâ€™s take your questions.

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. The share of home sales brokered by our own agents and through referrals to our partner agents also increased from 0.75% in the second quarter of 2023 to 0.78% in the third quarter.

Our share is still below its level from a year ago as we haven't fully recovered from the share loss in the first half of 2023 due to layoffs in 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 forecast the possibility of year-over-year revenue growth. 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 the housing downturn and revenues declining by 16%, adjusted EBITDA improved by $9 million. There will still be ups and downs, but mostly, we plan to keep drawing visitors away from rival sites due to the addition of rentals 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. 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. 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. 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 profit per quarter. 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 housings ups and downs. Even as we've developed at one digital revenue stream after another, we've gotten out of a business that involves holding hundreds of millions of dollars in houses and launched a pilot eliminating agent salaries.

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Comparing the third quarter of 2022 and 2023, visitors to redfin.com grew by 1%. 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 2 historical rivals, Zillow and realtor.com. According to Comscore data, the GAAP and year-over-year visitor growth between Redfin and these sites averaged 11 points in the third quarter. We'll continue measuring our progress against our long-time 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.

We attribute our success to a better search experience. We're still drawing more visitors from search insulins 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 and a fee that combines listings with market news and agent insights. 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 book per salesperson has increased 362% since the third quarter of 2021 when rent's new leader came on board.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jason Helfstein with Oppenheimer.

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

Glenn, I wanted to go into a little more detail about the West Coast agent change. So will this apply to all agents in the market? I guess the San Francisco and I think L.A. as well or just the new agents maybe talk about like the comp split? And then what's the financial impact if you decide to roll this out more broadly.

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

Jason, it will apply to all San Francisco and LA agents, not just the new ones we hire or not just the cohort of agents who choose that plan. So we do not know exactly what the implications will be. That's why we're running it as a pilot, but we expect that it will increase gross profit and that it will be largely gross margin neutral and the x-factor is just how many deals are self-sourced at the extreme. If you imagine that we hired agents who didn't close any Redfin source deals, well, then that would be a very different outcome than if they had the mix they do today where about 2/3 or 3/4 of their deals are Redfin sourced.

And so it really just depends on the mix. But to the extent that new agents bring in new business, we should have a lower margin only on the incremental revenue. And the goal is to improve the close rate on our high-margin business of closing Redfin source sales.

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

And so just to clarify, so effectively, the system will understand if it's a Redfin source deal, they get a lower payout and if they source that they get a higher pay.

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

That's exactly right. And we have good systems for tracking whether we were the source for a sale. If it starts on our website if it starts from an e-mail campaign.

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

Can you disclose the splits or you don't want to do that?

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

Well, no, we have. So there's a post announcing list in great detail to the agents we're trying to recruit. It's on our blog site, but the split is as high as 75% for self-source sales. And since we still offer benefits and cover marketing expenses, that's effectively a split like 90%, but it's less than half of that or about half of that for Redfin source sales. So this has 2 advantages. First of all, we think we'll be able to recruit agents who bring their own book of business, but are also quite effective at closing luxury sales because the issue in these high-priced California markets is that we've had a low close rate on $1 million-plus opportunities, but also it should make the business, as we noted in the script, more resilient than in the downturn, there will be risk shared between the agents and Redfin wears today, we're paying salaries through thick and thin.

Christopher Nielsen - *Redfin Corporation - CFO*

Just one other comment, Jason. I think the other benefit that may be obvious to us, but less intuitive to analysts is it's just very easy for a traditional agent to understand this compensation plan. We had to explain so much talking about salary and benefits and all these other things. And now when you just say, here's the split, people immediately recognize, oh, that's a good deal. It's caused a lot of chatter in the industry. Plenty of people who left Redfin looking for higher splits called me and said, I want to come back.

Operator

Our next question comes from Tom White with D.A. Davidson.

Wyatt J. Swanson - *D.A. Davidson & Co., Research Division - Research Associate*

This is Wyatt Swanson on for Tom. We just have a follow-up to that Max pay plan. Could you talk a bit about like your ability to expand that program profitably outside of markets like San Francisco and Los Angeles and what you think the mix of Redfin source leads and externally sourced leads would look like in a profitable market?

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

So we have contemplated expanding it across Redfin. The current model, the splits that we've designed will work in any high-priced market, and we'd have to modify that to have it work in a mid-priced or low-priced market, but it's fairly straightforward to scale a pure split model across markets just because it varies with the home price. And so it just almost adapts itself. I think your other question was just why do we think the split will be between Redfin sourced and agent source sales?

We really don't know that. Obviously, we want to recruit agents who are really good at closing Redfin Source sales because the higher that close rate is, the more intensely profitable those agents are. The single biggest lever that real estate services has is close rate. The history of 2023 is that we generated so much demand, but had falling close rates offset that. So we want agents who can close Redfin Source sales. But if we get agents who bring a huge book of business to us, I don't think we're going to look that gift horse in the mouth. The goal there was to make a few bucks on each of those sales. And so it should still be incremental to our profits even if that particular segment is lower margin.

So really, it just depends on how many agents on market recruits and how many customers each of those agents brings. And that's what we're going to report on every quarter as we start getting Redfin Max results.

Operator

Our next question comes from Bernard McTernan with Needham & Company.

Bernard Jerome McTernan - *Needham & Company, LLC, Research Division - Senior Research Analyst*

Great. To stick on the Redfin Max theme here. I would love to know just how long you're planning on testing for? And then what's the early traction that you're gaining with agents? What's the value proposition that's hitting, whether it's the support, whether it's the Redfin listing? Just would love kind of like a rank order in terms of what's mattering the most of the agents who are coming back to you.

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

Sure. So the value proposition is the best of both worlds at a high level, which means I get to bring my customers over, but I also get access to red fence customers. So access to the opportunities generated by our site is first, but also what we call business in a box, which is being set up for scale from day 1. So you come in, you have a coordinator to help you close sales. You have the showing assistants, which is our network of contractors who host property tours. You just have everything taken care of for you so that you can focus on developing your own network and closing Redfin sales.

So the early response to that has been good. The agents we're talking to are successful. So they're not coming to us out of desperation. They're really talking to their accountant and comparing what they could earn on the outside world and what they could earn at Redfin and then they're making the decision to come over. The length of the Redfin test could be as short as weeks for rolling out to a few additional markets to roll out nationwide. That would be more like a year. We're trying to work backwards from what are all the things we have to understand to be able to roll this out to every market.

You should just remember that for us to get a significant financial impact, we don't have to reach that many markets because the big high-priced markets are where we have the most agents and the most gross commissions. So we think that this could have meaningful financial impact by the summer, and we think we'd be in a good position to make decisions about whether to roll it out everywhere by then. Our assumption has been that this is part of our future. Whether it's part of every market's future or just part of the big markets future, TBD.

Bernard Jerome McTernan - *Needham & Company, LLC, Research Division - Senior Research Analyst*

Understood. Appreciate it. And then just a follow-up on the continued guidance. We're expecting to get to EBITDA positive by the end of the first half of next year. Just if you could just discuss kind of any other levers you can pull in the business while you're waiting for the housing market to get back either from a cost side or plans of higher returns on investment that could help you reach that goal.

Christopher Nielsen - *Redfin Corporation - CFO*

Sure. So a few comments there. I think one critical part is continuing to develop the digital businesses that we talked about on this call, continuing to expand the revenues we earn from advertising and other offerings on redfin.com, continue to grow. Our rentals business will be an important part of that. And then we do expect that we'll continue to have the opportunity to gain market share through the first part of next year into the year. That will be important in terms of building a stronger revenue base.

And I do think in the last part, we are, as Glenn mentioned on the call, paying an awful lot of attention to costs. We're deferring costs at this point until we can see more clearly what the housing market looks like. And we do have a variety of levers we could pull on the cost side of things. So we'll pay attention to that and only decide to move forward with those costs when we can see our way clear to daylight.

Operator

Our next question comes from Ygal Arounian with Citigroup.

Ygal Arounian - *Citigroup Inc., Research Division - Director of Internet Equity Research*

I want to maybe talk a little bit more about the NAR lawsuit has been the majority of conversations this week and last week. So I understood how the digital aspects of the brokerage you guys have built and give you an edge in that kind of environment where buyers have more tools for themselves. But can you expand on this a little bit. A, I thought the comments were interesting on potentially I think you implied licensing, some of this to other seller agents going to bring more sellers or more listings to Redfin, do you think?

And then the offset here is that you make a good amount of money from buyer agencies, right? So if buyer agencies, I'm sure you don't expect them to go away completely, but if they are reduced kind of in a dramatic way, does that have a negative impact? And then on the same topic, you guys were in the second round or the copycat 1 were listed as in that one, too. And I just want to maybe get a comment on how you think about that and what's the kind of potential liability could be out of that as much as you could comment on it. I understand it's a legal matter.

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

Sure. Well, why don't we talk about the copycat lawsuit first, mostly to say that we're not going to talk about it. As we emphasized in our earnings remarks, this company exists to give consumers a better deal for 18 years. We have busted our tail to work with the industry to find different ways to save people money, every possible configuration of a business that could put the customer first, we've tried it. And we are absolutely proud of everything that we've done, which means we have very good defenses for this lawsuit.

So I think your other questions were about just how we could leverage our platform in different ways. So obviously, it's going to be important for us to be able to use that platform to sell our own listings, but we do have a vast network of other agents who work with Redfin as our partners, and it may be that they would also want to use that platform to sell their listings directly to consumers. And so today, if there is someone who's trying to buy a Redfin listing or the listing of a Redfin partner, we route them to a buyer's agent, but we may instead say, we can route them directly to the listing agent, and there are various ways that we can monetize that.

So the key assets that we have are, first of all, this website and then all these tools that we've built over many years to make it easy for a buyer to set up his own tours to make it easy for a buyer to prepare his own offers to look at his own comparable sales and come up with its own price. And so we just think we're better positioned than anyone else. We take it as a given that several trends are going to continue. The first is that all year and probably last year too, commissions have been significantly compressing. That will continue.

Dual agency has increased in part because inventory has just been low. Because of all the attention this case is getting, many people are going to become aware of the fact that hiring a buyer's agent is a choice. And for many people, that may be a good choice, but other people may choose not to do that. And then the third thing that's really changed in the industry, especially over the past few months has been the proliferation of buyers agency agreements. The old saying was the buyers slide rather than decide. But now agents are putting that question explicitly to the consumer, do you want to hire me? Do you want my representation? Am I worth the money?

And that is very healthy for the industry. It's part of this sales initiative that we touched on only briefly in the scripted part of the call where we're now asking buyers to sign up with Redfin and offering them a commission refund when they do. So just in general, these are all trends that were already happening in the world. It's very unpredictable what will happen next. We think we're the most agile player with the largest digital asset among any brokers. And so the more the industry changes, the better position will be.

And if we have to make money by being listing agents instead of buyers agents, if we have to make money from being digital rather than focusing on service, I think we've demonstrated over the past year, dang, we can move fast to do that.

Ygal Arounian - *Citigroup Inc., Research Division - Director of Internet Equity Research*

Glenn. That's helpful. Maybe a follow-up from the comments you were making about home prices might be softening, you're seeing some signals. Can you expand on that a little bit? What the signals you're seeing are? And obviously, that's a really good thing for affordability, but sliding home prices also come with various other consequences for those that are looking to sell their homes. So I just wanted to get maybe some expanded thoughts on that point.

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

Well, first of all, I do see falling home prices is the only way to break the log jam. So we can argue about the social benefit of having affordable housing. That's a mixed bag in American politics because so many homeowners want to see their prices remain high. But for Redfin, just commercially and for any broker that depends on home sales, sure, we might make 1% less revenue per transaction because commissions are a percentage of the sale price, but transactions are not going to go up in a significant, meaningful way until prices become more affordable. The basis for our believing that, that could start to be happening are the following.

And I want to caveat this by saying this is the last element added to the script, the most hotly debated. Some of it is just based on my own personal conviction that I think something might -- there might be a disturbance in the force as they say. So number one, we've just had more listing consultations lately. So generally, demand has been pretty good on the Redfin side as we emphasized, we've had traffic and good pull-through from traffic into inquiries, but that's been especially strong on the sell side, which is unusual. We've really been inventory locked for a long time.

Number two, price drops have been strong. They're always strong in the fall because there's a bunch of inventory that didn't sell and it gets marked down, but it's stronger this year than at any point since 2015. And then the last part is just anecdotal and it's based in part on my own long experience here at Redfin that once there is any drop in prices at all, that brings more sellers out because right now, they think, well, time is on my side, if I wait until next year, maybe interest rates will ease and prices will either be the same or higher.

But if suddenly you get in a world where wow, I want to sell now because the market might get worse. I think that will get sellers off the fence. So look, there's a world where a catastrophic drop in prices really freezes up the market, too. But I think some softening in home prices is just like softening in prices and the economy across the board. It just gives the economy, which has been overheated a little breathing room.

Operator

Our next question is from John Campbell with Stephens.

Jonathan Bass

This is Jonathan Bass on for John Campbell. You guys have obviously done a great job turning the rentals business around. I'm hoping you can help unpack some of that strength we've seen. So how much of it would you accredit our self-help and then maybe share gains versus the macro?

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

Some of it is undoubtedly macro, but that business is just executing better because I actually think the conditions were better 6 or 12 months ago than they are now. And sales productivity is just through the roof. So John has done a really good job getting that sales force to execute. We're generating more demand where it matters the most, just lining that up against the customers we have who need demand. So, I do think there's just much better execution than there was before. And because there was so much foundational work that we had to do with the brand and renaming the company rents and unifying the code base between Apartment Guide and rent.com. We just now have a very clear feel to do some things where Redfin has deep conviction that it can drive traffic.

So sometimes you make speculative bets where you wonder, will anyone really like this. But when it's just firing up the e-mail campaigns and doing link building and working with recommendations, which have worked over and over again to bring people back to the site, it gives us good confidence that we can keep it going. So we just inherited a business that was broken in some ways coming out of bankruptcy, and we fixed it. And now I think we can build on that to go on the attack.

Jonathan Bass

Got it. And then maybe if you could dig a little further into what you guys are doing or what you guys need to do to hit those mortgage and title attach rate goals?

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

Some of it is just basic sales execution. It takes time, but you go from market to market, you meet the sales managers, you meet the agents. Sometimes there are agents who consistently are never recommending the equity. They are sales managers, whose whole teams are like that. You sit down and talk to those teams about whether you're really doing what's right for the customer or if another lender is sending you baseball tickets every month. So some of it is that.

What's impressive about Bay Equity is just, I thought those guys might rest invest and get very short-term oriented, and they're just animals. They are thinking about all sorts of long-term ways to make lending fundamentally better to lower our cost basis, to make our product more competitive. We just got a great team of people there, and we are really confident that we offer better service than other lenders and a better rate. So it will take time, but that number is going to keep going up. It can never go up to like 50% or 75% because money is a commodity, and there are always going to be some lenders who have a pre-existing relationship with a customer and decide to buy the business. But it can be much higher than it is now. And we're just going to keep grinding it up.

Operator

(Operator Instructions) Our next question comes from Jay McCanless with Wedbush.

Jay McCanless - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

So I wanted to find out when you talked about possibly deferring some of the costs you normally spend in the first quarter to -- for sales later in the year. Any type of commentary about what percentage maybe of OpEx that would be in a normal year? Or is it going to come out of your cost of goods sold? How should we think about that?

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

Yes. You should think about it in both places, maybe more so on the operating expense side of things. If you look back at our financial results, you'd see that we often spend marketing dollars in the first part of the year with the expectation they'll pull through later. I think that's a place you'll see us be pretty careful as the year starts including the campaigns we're running and what our plans are there. So we're paying an awful lot of attention to our view on the housing market. And so we can adjust marketing costs.

And then probably the second largest line item on operating expenses just is in head count. So that's another place where you'll see us be pretty cautious about both any kinds of new hires, but also, we're just scrutinizing literally every backfill in the company in those groups to make a good determination about whether that role is really needed moving forward. And then similarly, on cost of revenue until we can see more clearly to the demand patterns on things, we are being cautious about agent hiring and support staff hiring and kind of all those elements. So that we're building the right cost base for the year. So it's across the board, but those will be some of the key areas to call out.

Christopher Nielsen - *Redfin Corporation - CFO*

The theme song for this initiative is the who's won't get fooled again. We went through it this year because traffic was just cracking in January 2023. And so we had a good reason to believe that revenues would follow. Rates went up in March. And all this demand just didn't pull through, but we'd already committed some expense. And so we'll be more careful this time and really not only look for more people on the website, more people contacting our agents, but how many are coming back for a second tour, writing an offer, signing a listing agreement?

Jay McCanless - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

And then my second question, I don't know if you all have broken it down this way, but when you look at who's cutting price, is it across the board? Or are we talking more homes that are listing at 2x or 3x the median price of whatever the market they're in currently?

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

Pretty broad. I'm basing this on anecdote. I haven't broken it down into segments, but I've been going around the country, people who aren't selling their house, we used to have to talk them into lowering their price, asking what's going to get better at this time of the year? What's going to change except your price? If you want to remodel the house, maybe we can hold on to this price. Now I think people are saying, I get it.

Operator

Our next question comes from John Colantuoni with Jefferies.

Vincent Nugent Kardos - *Jefferies LLC, Research Division - Equity Associate*

This is Vincent Kardos on for John. Two questions, please. So first, maybe you could share any update you're able to on your outlook for the trajectory of market share? And then second, I know you talked a little bit about how you're going to be pushing out some costs in 1Q later in the year, but maybe any color you can provide on the trajectory of OpEx into 4Q? That would be helpful as well.

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

It's really hard to get a read on share because we know about our own sales. We just don't know what the rest of the market is doing. So we get numbers days before you do, just indicating via the MLS and later from the National Association of Realtors, how many sales our competitors got. The open issue for us is rates have really gone up. The market is suffering. Our demand has still been strong. It's just really hard to close that demand. It's a very unpredictable time. And this isn't me being a wean or trying to signal bearishness, it's just being cautious about signing us up for something when we really don't know.

Christopher Nielsen - *Redfin Corporation - CFO*

Historically, our market share from the third quarter to the fourth quarter has either been flat or headed down a little bit. So that would just be the best historical indicator, but there's not a lot more detail than we can provide on that.

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

The whole reason you track share is to avoid seasonality. For whatever reason, our seasonality has always been there on share. It doesn't make any sense, but it's always been true.

Christopher Nielsen - *Redfin Corporation - CFO*

And then just a comment on operating expenses. There's not a lot more that I can provide than we didn't provide already in the guidance on that. So we provided overall figures on what to expect in that way, but not a whole lot more color I can add to that.

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

I just had one closing comment because there have been some questions about whether we would extend Redfin Max. Just want all the analysts to remember that sometimes our employees listen to these calls. We are not going to expand Redfin Max unless we think it's good for our customers first, but also for our agents that we can serve customers better and everyone can make more money. So we think this can be really good, especially in these coastal markets, but the truest arbiter of our success is going to be the people in L.A. and San Francisco, customers and agents alike say this was awesome. And if they say that, you'll be lining up at the door for this new pay program because we'll all win.

That's it. Thanks for a great third quarter 2023 earnings call.

Operator

This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.
