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PRESENTATION

Operator

Good day, and welcome to Redfin Corporation Q4 2023 Earnings Call. (Operator Instructions) Please note that this conference is being recorded.

I'd now like to turn the conference over to the Head of Investor Relations, Meg Nunnally. Please go ahead.

Meg Nunnally ***Redfin Corporation - Head of IR***

Thank you, operator. Good afternoon, and welcome to Redfin's financial results conference call for the fourth quarter ended December 31, 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 while 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 measures and related reconciliations. All comparisons made in the course of this call are against continuing operations for 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 it over to Glenn.

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

Thanks, Meg, and hi, everyone. Redfin's fourth quarter earnings were in the middle of the range we gave investors in our last call, a $23 million net loss on $218 million of revenue. Our adjusted EBITDA loss for continuing operations was $13 million, a $27 million improvement over the fourth quarter of 2022.

The fourth quarter's only disappointment was a market share decline. The share of home sales brokered by our own agents and through referrals to our partner agents was 0.72% down from 0.76% in the fourth quarter of 2022 and from 0.78% in the third quarter of 2023. Our market share already recovered in January, increasing above the fourth quarter level.

We expect share gains to continue in 2024, with much of the revenue from that gain falling to the bottom line. We ended 2023 having lowered full year operating expenses by $62 million, with fourth quarter gross margins improving from 25% in 2022 to 34% in 2023. And we have ample opportunities to grow, using Comscore to compare redfin.com's online audience to that of our 2 main historical rivals, redfin.com grew 13 points faster in 2023.

The grow sales alongside traffic, we've advanced 3 initiatives to attract better agents and deliver better service. In some pilot markets, we shifted our agents to all variable pay. In others, we restored commission refunds for customers who signed a buyer's agency agreement. In still others, we've required our sales people to meet customers on their first tour. Our agents have embraced these initiatives. And already, we're closing more sales. These initiatives are now being broadened to yield a financially meaningful impact in the summer, with all 3 likely to be nationwide by early 2025.

In the meantime, we're working hard to introduce more customers to our brokerage. According to Comscore, fourth quarter visitors to redfin.com grew 10% year-over-year, while the growth rates of our 2 main historical rivals were 1% and negative 1%. One factor driving our growth is expansion, once limited to homebuyers in mostly coastal cities, redfin.com now spans homes for rent and for sale nationwide. The markets we've opened by adding listings give us room to build our audience for years to come. And redfin.com keeps getting better, not just bigger. In the fourth quarter, we became the first major site to use artificial intelligence for home shoppers to visualize how a home could be redecorated, first, in mid-Atlantic markets, but with plans to expand this spring.

Redfin.com is also surfacing more of our agents' local expertise, giving greater prominence to our insights about homes we've toured and capturing new insights about the neighborhood. Here too, we're exploring the use of artificial intelligence, turning raw notes from an agent's phone into a well-phrased comment. Publishing this proprietary information should draw more visitors to our site, and we hope convince more of those visitors to use a Redfin agent. But to compete for sales, not just traffic, we're expanding the 3 fourth quarter initiatives identified at the outset of our call. Since our sales cycle is 6 months, we won't know for sure how well these initiatives are working until April at best, but the early indications could hardly be better.

The most significant of these initiatives is Redfin Next, which replaces agent's base salaries with higher commissions. We launched this program as Redfin Max, but changed its name to avoid any confusion with RE/MAX. As of February 22, the revenue closed for January and February in the 4 California markets piloting Next is up 32% year-over-year, while the rest of the brokerage is down 1%. In May, we plan to expand Redfin Next to 7 more markets out of more than 100 Redfin markets total. With the expansion, Next we will reach markets that accounted for about 1/3 of Redfin's 2023 brokerage revenues. If the second stage of the pilot goes well, Redfin Next could become our Redfin-wide agent-pay plan in early 2025.

The Next agents we're hiring are coming in large part for the opportunity to meet more customers, but will earn traditional splits on the customers they source themselves. Hiring agents who aren't entirely dependent on our site makes Redfin more resilient to housing market volatility, especially now that we've replaced salaries with larger bonuses.

In the 4 pilot markets, a Next agent is profitable after closing 4 Redfin sourced sales per year compared to 7 previously. As we gather more data on how many customer introductions our Next agents need to be productive, we can be even more aggressive about hiring in 2025. This gives us room to gain share coming out of downturns while limiting our fixed cost headed into downturns. We've had the most success bringing on agents who already know how to be systematic about online opportunities. One Next agent who had been paying a portal $10,000 to $15,000 per month said "he planned to see how it went here at Redfin for a couple of months. But within a few weeks, I started bringing over my team." Another said "she never had so much support to run my business. I'm busy in getting good customers from the site."

Beyond Next, the brokerage's other 2 initiatives work together to earn a sale from the first meeting between a customer and an agent. All You Can Meet requires a Redfin agent to meet customers on their first home tour and Sign-and-Save restores commission refunds to homebuyers who hire us after that first tour. We tested each in different pilot markets in part to understand if an emphasis on meeting customers could drive sales gains by itself without a commission refund.

The problem these 2 initiatives address is that portal visitors use agents as a home touring service. Customers who are -- or excuse me, consumers who were once likely to hire the first agent they met now use Redfin and other website to schedule 3 different tours with 3 different agents. To honor so many tour requests, Redfin uses contractors to handle tours when our employees are unavailable.

All-you-can-meet assigns customers only to lead agents who make themselves available to host the customer's first tour. Agents with more availability get more customers. We still use contractors for subsequent tours, but in the event a lead agent can't break free to host the first tour, we route the customer to a partner agent at a different brokerage, which pays us a referral fee.

Since we launched the All-You-Can-Meet initiative on November 15, 2023, Redfin agents in the 4 pilot markets have gone from hosting 60% to 65% of first tours to hosting virtually all of them. Just last week, we expanded this initiative to reach more than 50 markets. Our Atlanta market manager says it has restored lead agent as the face of Redfin.

Meeting customers on their first tour sets up the Redfin agent to offer a commission refund of 0.25% to 0.5% to customers who hire us before their second home tour. We memorialize the hiring decision and the refund amount in a buyer's agency agreement. Restoring refunds is a reversal for Redfin as we had concluded in the fall of 2022 that refunds were not an effective sales tool. But we believe that was because many agents didn't use the refund as a sales tool, rarely mentioning it to customers, and never asking customers for a commitment in exchange for the refund. We now expect agents to discuss the refund on the first tour. The customers can decide whether it's worthwhile to sign the buyer's agency agreement before the next tour. Our guess is that about half our sales will come from customers who sign the agreement and get the refund and half will come from customers who later decide to work with us without a refund.

This customer incentive, known as Sign-and-Save, launched in 4 markets on September 21 and is already increasing sales. By comparing close rate gains in pilot markets and control markets, we concluded that pilot market homebuyers are 24% more likely to write a winning offer via Redfin within 60 days of their first tour. The 24% increase spanned customers who signed the agreement to get a refund and those who didn't, it's easily large enough to offset the cost of the refund for those customers who got it.

In March, we plan to expand the pilot to almost every market, excluding only markets in a handful of states that outlaw commission refunds. We believe a more motivated Next agent set up by our system to meet every customer, with an offer a few other brokerages can match, will deliver significantly better results.

Bay Equity, the lender we acquired in April 2022 is also improving sales execution. In the fourth quarter, a higher proportion of our brokerages homebuyers used Bay Equity for a mortgage. Attach rates have declined from 19% in the second quarter to 18% in the third before bouncing back to 19% in the fourth.

Excluding cash buyers, Bay Equity's fourth quarter attach rate was 25%, up from 22% in the third quarter and 24% in the second. Projected attach rates for the first quarter of 2024 are even higher. We expect that growth to continue through the rest of 2024, driven by simpler manager incentives and in markets where the law allows it, new agent incentives. We've also integrated Bay Equity deeper into our sales process, automatically alerting loan officers not only when a customer first asks to tour a home, but also now when her offer has been accepted.

Another basis for optimism is the lending industry itself, which has reduced staff to the point that competitors have been less willing to lose money on loans, giving us room in 2024 for improving gains on sale. If rates ease further in the back half of the year, we also expect to refinance more mortgages with demand coming from our website, but also from our database of past customers.

Potential improvements in the for-sale market may buoy our brokerage and lending businesses, but the customers of our rentals business are under pressure from higher vacancy rates. Even so, Rent generated $3 million of fourth quarter adjusted EBITDA on 20% year-over-year revenue growth, with positive net bookings. This is the second consecutive quarter of adjusted EBITDA profits for a business that as recently as the first quarter of 2023 lost $9.7 million in adjusted EBITDA.

To grow revenue and earn a full year adjusted EBITDA profit in a more challenging market, we're now integrating Rent and Redfin human resources, finance and legal departments as well as technology infrastructure. Starting this summer, and continuing through the first quarter of 2025, we expect significant savings from migrating to one cloud platform, one HR system, one finance system, one benefits plan.

These efficiency gains will let us invest more in rent.com and apartmentguide.com and more in Rent sales and industry marketing, which we'll still run from Atlanta. Redfin and Rent will work together to increase tenant inquiries for Rent's customers, drawing on Redfin's expertise at attracting visitors from search engines, using machine learning to engage those visitors and experimenting at scale to generate more leasing demand from our audience. These efforts will take months to bear fruit, but should lead to a larger, more profitable rentals marketplace.

Rent is part of a larger initiative to generate more revenue from digital sources. Our other business segment, which consists of Title Forward and digital channels, grew fourth quarter revenues to $10 million, up 54% year-over-year. Title Forward grew fourth quarter revenues 32% and is generating its first full year gross profit since 2019. Our digital businesses, which include a mortgage marketplace, display ads on redfin.com, lead generation for builders and syndicating Walk Score to other real estate sites grew fourth quarter revenue 101%. We've now hired an experienced leader to build our display ads business and expect further revenue increases in 2024.

Before turning the call over to Chris, let's discuss the housing market which is still almost entirely driven by mortgage interest rates. Our concern has been that 2024 will turn out like 2023 when rates approached 6% in January then rose, peaking above 8% in October. Rates subsequently declined approaching 6.5% in mid-December until climbing again to above 7% in February 2024. This recent rate increase has dampened 2024 demand. But the people now coming into the housing market know what they're getting into, having become more accustomed to mortgage rate volatility.

Some also seem to recognize that when rates do ease, the market is likely to get more competitive. Already, our agents have reported a mostly seasonal resurgence in bidding wars at one extreme, a Fremont California listing got 50 offers last week. Redfin's listing demand increased sharply coming into 2024, but moderated in February. Home buying demand wasn't as strong, but has held up better, from customers asking to tour their first listing with Redfin all the way through to book sales.

Industry-wide, seasonally adjusted existing home sales increased in January to an annualized rate of 4.0 million after being below 4.0 million since September. If there isn't a significant further increase in mortgage interest rates, we expect 2024 home sales to remain at or above the 4.0 million level through the first half. If there is any mortgage rate relief in the spring, the second half could be much stronger.

We aren't counting any chickens until they hatch. To minimize the first quarter losses we usually incur in anticipation of our busy season, Redfin deferred mass media advertising until the second quarter, hosted our sales kick-off virtually and limited first quarter business travel to employees in sales. Rather than waiting for a major housing market recovery, Redfin plans to grow, at least modestly through market share gains, by competing better for traffic and for sales, and then much faster when the housing market recovers.

Take it away, Chris.

Christopher Nielsen ***Redfin Corporation - CFO***

Thanks, Glenn. The fourth quarter closed a challenging year for the housing industry. Still, we're pleased with the work we've done to improve profitability, and position the business to capture growth when the market begins to recover.

Fourth quarter revenue was $218 million, down 2% from a year ago. At the same time, gross profit of $73 million was up 32% year-over-year and total gross margin expanded from 25% to 34%. Each of our segments increased gross margin year-over-year and our higher margin rentals and other segments grew faster than the rest of the business. Our adjusted EBITDA loss of $13 million was up from a loss of $40 million in the prior year. For the full year 2023, our adjusted EBITDA loss was $76 million, up from $145 million in the prior year.

We've been saying for several quarters that we're working towards a goal of trailing 12-month adjusted EBITDA breakeven by the first half of 2024. This is still possible, but less certain now given how mortgage interest rates have started this year but we're on track for full year profits.

Turning to our segment results for the fourth quarter, real estate services, which includes our brokerage and partner businesses, generated $133 million in revenue, down 9% year-over-year. Brokerage revenue was down 11% on a 20% decrease in brokerage transactions, partially offset by a 12% increase in brokerage revenue per transaction. The increase in revenue per brokerage transaction was driven by the reduction of our home buyer commission refund, revenue from concierge renovations and a 4% increase in average home prices. Revenue from our partners increased 19%, on a 16% increase in transactions and mix shift to higher-value houses.

Real estate services gross margin was 22.5%, up 450 basis points year-over-year. This was primarily driven by a 590 basis point decrease in personnel costs and transaction bonuses and a 100 basis point decrease in home touring and field expenses, partially offset by a 190 basis point increase in seller home improvement expenses, each as a percentage of revenue. Net loss for real estate services in the fourth quarter was $21 million, up from a net loss of $28 million in the prior year and adjusted EBITDA loss was $7 million, up from a loss of $16 million in the prior year. The increase was attributable to higher gross margin and lower operating expenses, which more than offset lower revenues.

Our rentals segment posted its fifth straight quarter of growth with revenue of $49 million, a 20% year-over-year increase. Rentals gross margin was 77.5%, up from 76.4% a year ago. Net loss for rentals was $10 million, up from a net loss of $22 million in the prior year. Adjusted EBITDA for the fourth quarter was $3 million, our second straight quarter of positive adjusted EBITDA for the rentals segment.

Our Mortgage segment generated $26 million in revenue, down 8% year-over-year. Mortgage gross margin was 4.6%, up from a negative 8.9% a year ago. This was primarily driven by a decrease in personnel costs as a percentage of revenue. Net loss for mortgage was $5 million, up from a loss of $12 million in the prior year. Adjusted EBITDA loss was $5 million compared to a $10 million loss in the prior year.

Our other segment generated revenue of $10 million, up 54% year-over-year as both our title and digital revenue businesses grew. Other segment gross margin was 40.6%, up from 7.4% a year ago. Net income was $2 million compared to a $1 million loss in the prior year. And adjusted EBITDA was positive $3 million compared to a negative $1 million in the prior year.

Turning back to our consolidated results. Total operating expenses were $117 million, down $25 million year-over-year. The decrease was primarily attributable to $13 million in lower restructuring expenses, $3 million in lower marketing expenses and $2 million in lower personnel expenses. Net loss was $23 million compared to a net loss from continuing operations of $27 million in the prior year or $62 million, including discontinued operations. This is within our $27 million to $18 million loss guidance range includes a $25 million gain on the extinguishment of notes, which was anticipated in our guidance.

Our adjusted EBITDA loss was $13 million, in line with our guidance range. Diluted loss per share attributable to common stock was $0.20 compared with a loss of $0.25 one year ago.

Now turning to our financial expectations for the first quarter. For the first quarter of 2024, total revenue is expected to be flat on the low end or grow 4% on the high end. Real estate services revenue is expected to decline 1% on the low end or grow 3% on the high end with gross margin around 14% to 17%. We do not expect a material change in revenue per brokerage transaction as a result of the homebuyer refund that Glenn mentioned earlier. Rentals revenue is expected to continue to grow between 13% and 16%, mortgage revenue is expected to decline between 20% and 11%.

Finally, other segment revenue is expected to grow between 28% and 29%. Total net loss is expected to be between $72 million and $65 million. Adjusted EBITDA loss from continuing operations is expected to be between $36 million and $29 million.

And with that, let's take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Naved Khan of B. Riley Securities.

Naved Ahmad Khan ***B. Riley Securities, Inc., Research Division - MD of Internet Equity Research***

Yes. Just a couple of questions from me. So just on Next, it's great to hear the breakeven on this one is faster versus your traditional model. But my question is on the flip side of this, i.e., if there -- if you're in a healthy market, does it actually cap the potential profitability and revenue as well because you're -- it's more of a variable structure.

The other question I had is around rentals. So we heard from Zillow a few weeks ago, and they were seeing continuing strength in rentals, wondering if there's a disconnect or in different markets where we should be seeing slowdown in your rental book? And maybe for Chris, the last question on the sort of the goal of getting to EBITDA breakeven in the first half, are we now looking at full year '24? Or how should we think about that?

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

Chris, why don't I take the first 2 and you can handle the third. On Next, we are not worried about capping the upside. We think that the gross margin profile for Redfin sourced deals will be similar or better to what it has been with our salaried employee model. If Next agents start doing more self-source sales where they bring customers to us that will have a different margin profile, but it will just be incremental gross profit. And I think that's less driven by the cycle than it is by just the mix of business that different Next agents will offer Redfin, but it should be incremental gross profit growth and monetizing our website, it should be a similar gross margin.

The larger point in a bull market is that Next will allow us to be more aggressive about hiring because we have fewer fixed costs, we can add agent capacity. I think the critique of Redfin has sometimes been that extreme market volatility has meant that we were one step behind in a downturn because we couldn't let people off fast enough. And then we were one step behind in a sudden rally because we couldn't hire people fast enough. But because the Next agent is profitable with almost half the number of sales that a salaried employee is we could be more aggressive about hiring those agents without carrying so much fixed cost.

So I think it actually gives us upside in a bull market. On the Rentals segment, Zillow might be more bullish than we are. It's just a matter of degree. 2023 was a really strong market for rentals marketplaces. There was at least a 20-point tailwind in the market, and that is moderating slightly because more buildings are coming online. So I think there is some lease-up opportunities if you are the vendor chosen to help fill those buildings, but most of the customers who are just trying to maintain their buildings have more budget pressure because they're having a hard time just meeting their loan covenants and keeping their buildings full.

Christopher Nielsen ***Redfin Corporation - CFO***

And this is Chris. I can comment on our profit targets. We are still working to profits on a trailing 12-month basis through the first half of this year. I'm not sure I have a lot to add other than my comment, which is that's still possible but less certain. And the big variable here is about revenue growth in the second quarter. We don't have a lot of visibility to that at this point. And we know that it will be subject to mortgage interest rates, which have started the year really higher than we expected them to. And so that's the piece that we'll be watching. But really, this is about the revenue growth in that next period as opposed to anything else.

Operator

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

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

Maybe just a follow-up on the EBITDA or kind of cash flow timetable. I guess the question is more, I guess, related to your liquidity. The balance sheet looks strong in terms of cash and equivalents. I think it's nearly $200 million. But Chris, maybe could you just walk us through like your kind of required sort of debt pay down or paying down on the warehouse over the next 12 months? And just kind of trying to think about your cash needs on that front relative to the $75 million kind of minimum cash balance you have to keep as part of that Apollo deal. Like maybe just you can describe how you're sort of -- you guys are feeling about that? Like do you feel like you've got the flexibility to kind of do what you need to do to reposition the company for growth once the market picks up?

Christopher Nielsen ***Redfin Corporation - CFO***

Yes, the short answer to your question is we do feel good about our capital position. So at the end of the quarter, we had $195 million of cash and equivalents on the balance sheet. It's important to note also that we have another $125 million that we could draw from Apollo as part of the transaction. So that gives us plenty of capacity there against the notes that we have due in 2025, which are now down to $193 million after the repurchases that we've been making. So again, we feel like we've got plenty of capital to manage the business here. We're focused on driving the profits and beyond that, but we do feel like we've got the right flexibility to continue to navigate the business through all of that.

Operator

The next question comes from [Dae Lee] of JPMorgan.

Unidentified Analyst

I have two. First one, following up on Redfin Next, I'm just curious to think on what the early feedbacks have been like? And you can notice that the some key differences in the performance between your Next agent and your traditional agents. And I have a follow-up.

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

Sure. I just want to make sure I heard the question. Could you repeat how has the reception been among the agents we hired?

Unidentified Analyst

Yes. So what are the early feedback been like among the agents that you hire and if you're noticing any key differences in performance between your Next agents and your traditional agents.

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

Great. Well, the feedback has been, first, that contact quality has been better than they'd expected. Many of them have been paying to meet customers through other websites, but Redfin just has a long history of eating its own dog food, where the opportunities we generate are served by our own employees, so that feedback loop over many, many years has just made us focus on qualification more maybe than other websites. And so agents have been pleased that the quantity, especially the quality of opportunities that they're getting.

Maybe the second point is that they're happy about what we call a business in a box that to succeed as an agent, especially at scale, you sometimes have to hire a transaction coordinator. You might want some people to help you with tours on the weekends. People here are set up from day one to be top producers where all of that infrastructure is taken care of. And then they love the systems. The challenges are making sure we support not just the brand of Redfin, but the brand of the agent. That's an area where other brokerages have really excelled. And then just making sure we support their autonomy. These are people who are used to working for themselves. They are more entrepreneurial. We see that as a feature, not a bug. And so far, it's just been fantastic. So we're really excited about that. They behave differently.

To get to the second part of your question, mostly in terms of how they view the opportunities that they get from our site as precious, but also as a starting point for building their business. So it's not just -- I'm going to get a sale from this one customer, but I'm going to use it to generate referrals. So they are mining our customer database. They're surprised at how much access they have to past customers of Redfin in their neighborhoods and they're just working hard or not just to work off the new opportunities, but to create sales from the repeat and referral business. So those are the main differences. It's really rejuvenated the culture of Redfin, not just among these new hires, but among all of the other agents who see how aggressive the new hires are about prosecuting these opportunities. It's been fantastic.

Unidentified Analyst

Got it. And I guess as a follow-up, it's great to hear that you guys are expecting to gain shares through 2024. So first of all, just curious why shares have declined in 4Q? And wondering what gives you the confidence in your share gain expectations as we move through the year?

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

Well, the 3 sales initiatives we outlined are what give us confidence. Close rate has been declining for many, many years. So to include in this print an actual close rate gain from the Sign-and-Save program where we tie the commission refund to a buyer's agency agreement, that is a seismic result from my perspective. And I know it's still early because we're just judging off the first 60 or 90 days, this cohort of customers who met us in November or December, how many of them have closed. But it's a very positive sign and to see also this very strong revenue growth in these high-end coastal markets like L.A., San Francisco, San Diego and Orange County, where we have had real share problems for 2 or 3 years. That, again, is a massive reversal.

And so all of these initiatives started in September or October, some of them in November. And they're just now taking hold. And the fact that we seem to be 3 for 3, that all 3 are working really makes a difference. And the proof there is that we've scaled them very quickly. Normally, we take a year or so because the benefit is quite marginal. It's hard to identify. You have to wait for the data to cure over a long period of time. But sometimes the result is so big and obvious you just push the button and let it go bigger. And so if things hold up the way that they are, we're going to have a really good year because traffic has always been a strength of Redfin and now we're coupling that with really great sales execution.

So as for Q4, what happened, I don't know. I mean part of it is that we sometimes tell our listing customers not to put their homes on the market in November and December. I don't think other brokerages are as aggressive about that, a traditional agent if he has an opportunity to activate a listing, he or she is going to take it, whereas at Redfin, we tend to think that it's in the customer's best interest not to list during the holidays and to push it out until January.

But that doesn't explain all of it. Sometimes you just have mixed sales results. And now that we're doing something different, I think we're going to have much different sales results. I was not happy about the share print in Q4, and I'm very excited about it going forward. I think we're on the right track.

Operator

The next question comes from John Campbell of Stephens Inc.

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

Glenn, maybe on a big picture industry question, I might be looking too far into this. It seems like the new Sign-and-Save program is basically implying that you guys see a future or, I guess, a potential in the buyer agency agreement. My question is, do you think the industry eventually aligns with you and that the buyer agency agreement becomes a new standard in time?

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

Partly, yes. I mean that's already happened in markets like the D.C. area market and Seattle. It's required for buyers to sign a buyers agency agreement. I think some of this is about legal and regulatory compliance. Some of it is just an ethical mandate that people should not hire a buyer's agent without realizing it. They should know what that buyer's agent charges and they should know what services are entailed. They should know when they're committed. And so this is good salesmanship, but it's also just an above-board way to treat a customer.

Now the reason that I said partly is that we're also seeing some trends where more listing agents are selling homes directly to home buyers. So I think there is just going to be more consumer choice, John. In some cases, a consumer is explicitly going to decide that I want somebody on my side, that I want my own agent and other times the agent -- the listing agent, excuse me, will be the 1 handling both sides of the sale. The buyer is going to go directly to that listing agent. I don't think that's going to be the majority of cases, but I do think there's going to be clear consumer choices and more consumer power. That's great.

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

Yes. Makes a lot of sense. I'm surprised you didn't go in to plug for Redfin Direct. So maybe if you could talk about that and where that might have a spot in the new world.

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

Man, I never missed an opportunity to give a plug. I was trying to be concise, but we've obviously built software that makes it easier for buyers to submit offers directly to Redfin listing agents because we wanted to support this capability for buyers to work without a buyer's agent. And the challenge that we've had when trying to scale that beyond Redfin listings is that many traditional listing agents do not welcome direct buyer contact. And I think that is changing because there is so much pressure on listing agents to support more consumer choice. And as that pressure mounts, the power of Redfin will be fully unleased, John. How is that for a plug?

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

Excellent. Good run down. If I could squeeze in maybe one more. The mortgage segment, obviously, you guys are doing great with the attach rates. You're doing as good as you can do with what the market is giving you. Obviously, eventually, we're going to see lower rates whenever that might be. I'm curious about where you guys are capacity-wise. Are you in a good spot loan officer wise? And then also -- are you -- is the business position where you can capitalize on refi as that comes back as well?

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

We've been worried about being able to capitalize on refunds. So hopefully, we stay ahead of that. I think rates have to drop another 75 basis points before the refi opportunity becomes significant. But traditionally, Bay Equity was doing 1/3 to half of its business in refi, don't quite quote me on that, but I think it was something like that. And they do have capacity. They have capacity just because the whole lending industry has capacity. Most lenders are still anxious to do more business, but also because they just got a great recruiting proposition.

There are so many lenders who have been working with Redfin agents who have joined Bay Equity because now they see that Redfin agents are not going to recommend that lender unless they have the full power of Redfin's one-stop shop. The economics are better. We can offer the consumer better value. The integration is better. So it's a more seamless experience. And so those lenders are under pressure to join Bay Equity/Redfin instead of hanging their own shingle and that's made it just easy for us to add loan officer capacity when we need to. Not easy but made it easier. Recruiting top talent is always hard, but made it easier.

Operator

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

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

Just staying on mortgage for a second. I'm surprised that the level of revenue decline you're forecasting given you expect real estate services to show at least a small gain. Maybe talk about the disconnect between those two?

Christopher Nielsen ***Redfin Corporation - CFO***

Sure. Well, I do you think it's possible that we generate more revenue in the mortgage business. So that's one potential outcome here. Another thing, just to remember, is that there's a little bit of a timing difference in the recognition of revenue and real estate services, which we get at the time that the transaction closes versus mortgage where we book some of the revenue upfront. So the revenue in mortgage tends to be a little less volatile, and that's probably what you're seeing between the fourth quarter and the first quarter of 2024. We are really encouraged with the attach rates we've seen in the first part of this year, going back to Glenn's earlier commentary. And so that has us quite optimistic as the year goes on.

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

Okay. And then the second question I had, could you potentially quantify how big the demand decline was from January to February.

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

No, I don't think we can. And it's not just that we're being cagey about it. It's a seasonal business. There are so many factors. We kind of argued in preparing for this call, whether or not this January to February feels different than 2023's January to February and maybe sales are pulling through a little bit better. We can't tell if that's our sales execution or if the markets like that, there was a commentary in the prepared remarks about buyers just being more accustomed to rate volatility. They know what they're getting into. They're not as easily phased. So I don't know if we can prove it, but it just feels a little bit better than last year. And certainly, we're better prepared for it. We were starting to gear up last year, and now we feel like we're not going to be fooled again, and we're going to be more careful about it.

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

Got it. And then the last one I had, I think, Chris, you made this comment about mortgage rates being higher so far this year than what you guys were expecting. I guess, what is kind of the Redfin house expectations for mortgage rates this year, especially with a lot of economists calling for mortgage rates to dip in the back half of the year versus the front half.

Christopher Nielsen ***Redfin Corporation - CFO***

That's very much what our economics team has been indicating is that they expect that rates will come down as the year goes on. And my commentary was really that rates did tick up in the first part of this year. And I think we're all watching now what the trajectory looks like over the next few months.

Operator

The next question comes from Nitin Bansal of Bank of America.

Nitin Bansal ***BofA Securities, Research Division - Research Analyst***

This is Nitin on behalf of Curt Nagle. Can you throw some light on how volatile has been buyer demand related to rates over the past few months. January volumes look better, but have you seen any pullback with rates now at 7% and pricing not easing? And secondly, what is your view on home supply? And how did -- how much do you think it can improve (inaudible) still very rate locked.

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

Well, answer to your first question about volatility, the market is still very much driven by mortgage interest rates, but maybe 1 degree less than it was 6 to 9 months ago. Some people just put off their home buying plans for 6 months, for 9 months, for 12 months. And at some point, they have priced into all of their calculations, a mortgage rate of around 7%. And I think if rates keep going up, there's always a breaking point for different cohorts of homebuyers, but it's been slightly more elastic than it has been in the past. I used to feel like man, it would be just the tiniest tick up and people would say, no, (inaudible). And now it just feels that people are a little more hardy about it.

As for supply, that's going to be a long-term problem in the U.S. economy when you have this much mortgage interest rate volatility and you're guaranteeing people loans for 30 years, you're going to have a long-term problem with resale inventory that should ease a little bit every year. Again, you just have some powerful demographic forces. Boomers are holding on to their homes longer, millennials are waiting longer to buy a home, but that can't last forever. And so we do think that the supply problems are going to ease and also construction has gotten a little better, too.

Operator

(Operator Instructions) Our next question comes from Ygal Arounian of Citigroup.

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

Given how important this is for you guys. I just want to expand a little bit more on the agent model, a, on the push to move more of the lower profitability transactions to partners clearly continuing to step into that? How is that going relative to your expectations? Is that something you expect to do more of? And then -- just any more incremental color on Redfin Next? And what are some of the signals that you're looking for? You talked about going into 1/3 of markets, can that potentially become more. It looks like that's been more successful than you expected and it's been ramping quicker than expected.

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

Well, first, on the push to partners, we do expect that to continue from year-to-year, from month to month, it's subject to the exigencies of the housing market. So once we've hired a certain number of agents, we're going to keep them busy taking more demand from partners or sending demand to partners. But mostly, we've been pretty careful about adding brokerage headcount because of this long-term shift to partners and this push to have a more digital margin at Redfin, which I think you see across the entire print. There's just higher gross margins in real estate services and across the business overall.

So that is the long-term trend. There might be some volatility in the mix between partners and employees from month-to-month, but mostly it's going in one direction. And as for next, maybe the only commentary that we haven't provided is about how eager the other markets are for it. There are plenty of sales initiatives that Redfin headquarters foists on different markets. And sales leaders are often quite conservative. They want to keep doing what they've been doing. They don't like as much change. That is not the case with Redfin Next. I have never seen so many employees lined up saying please cut my salary, so I can have a higher bonus.

The first run for Next, where you have a 2-week payroll run, somebody got a $90,000 or $91,000 commission check. I don't know that we've ever had a check like that in January, and it was just for 2 weeks. The word spreads like wildfire, markets are clamoring for it. And the only reason that we're not rolling it out even faster is we just don't want to screw it up. Right now, we've got one initiative, Sign-and-Save, which trades commission refunds for a buyer's agency agreement that we're scaling across the company in 2024, we think that's going to significantly lift close rates.

We'll expand Next somewhat more cautiously just because recruiting and change management for the existing employees is a lift, but every single market manager, it seems like most of our agents are clamoring for it. And I've talked to a bunch of the agents we are recruiting. And it's just an amazing level of talent. It's really, really exciting. If you pair kind of the best brokerage website with the best agents, you're going to take the world by storm. So early days, but we feel pretty excited about it. We feel as good as we could after just 30, 40 days of doing it in 2024.

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

A follow-up, I guess, on the point on traffic. I guess, one of the biggest, let's say, the debate areas right now and among investors is maybe a little bit of what's going on in the competitive environment, a bit of a step-up in marketing spend to say a lease from a key competitor and lots of discussion debate on how all that might play out? And from your seat, if you guys are kind of seeing this play out what you think about it, what your strategy is and how you kind of plan to I don't know if rebut against that is the right way to think about it, but just plan against some of what you're seeing there on the competitive side.

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

I don't want to be cocky about this. To be honest, I spent half the Super Bowl in the bathroom or upstairs making nachos because I didn't want to see these competitor ads. But according to the early reports from Similar Web and other sites to compare traffic. We still got more traffic on Super Bowl Sunday than the company promising to spend zillions of dollars. And our basic thesis is that the best product wins, if you build a better mousetrap, the world beats a path to your door, and we really believe in the quality of our website. I think there was sort of this 1999.com thesis that advertising dollars was the way to win. But mostly, I thought we had left that behind.

And I know that when you get into some kind of advertising war, it depresses margins across the segment, it changes the competitive dynamic. We're certainly aware that there are better capitalized competitors out there. But things have gone better than we could have hoped. I've been really worried about this last year. In June and July, we just told our traffic team. Here it comes. It's coming on strong. It's going to last a long time, keep your head down and keep working. And we weren't sure what the effect would be. But now we know. We've taken a punch, and we're still standing and actually, we're still growing. So we feel pretty good about it.

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

All right. That's really helpful. I agree with the quality of the website.

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

Chris, do you have anything to add on that one?

Christopher Nielsen ***Redfin Corporation - CFO***

I don't.

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

Sorry, Ygal, keep going.

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

No, that's it. I agree with the quality of the website. That's helpful comment.

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

Yes. Well, I think that's all the questions. As always, we just wanted to say how much we appreciate the analyst community for following our daily moves. If you have further questions, Chris and Meg will handle them one-on-one with you, but here's to a great 2024. Let's go get them.

Operator

Thank you. Ladies and gentlemen, that concludes today's event. Thank you for attending, and you may now disconnect your lines.