Presentation

Operator

Good afternoon. My name is Ailee, and I will be your conference operator today. At this time, I would like to welcome everyone to the Zillow Group's Third Quarter 2021 Conference Call. Please note, this event is being recorded. Thank you.

I would now like to turn the conference over to Brad Berning, Vice President, Investor Relations. Please go ahead.

Bradley Allen Berning

Thank you. Good afternoon, and welcome to Zillow Group's Third Quarter 2021 Conference Call. Joining me today to discuss our Q3 results are Zillow Group's Co-Founder and CEO, Rich Barton; and CFO, Allen Parker.

During the call, we'll make forward-looking statements about our future performance and operating plans based on our current expectations and assumptions. These statements are subject to risks and uncertainties, and we encourage you to consider the risk factors described in our SEC filings for additional information.

We undertake no obligation to update these statements as a result of new information or future events, except as required by law. This call is being broadcast on the Internet and is accessible on our Investor Relations website. A recording of the call will be available later today.
During the call, we will discuss GAAP and non-GAAP measures, including adjusted EBITDA, which we refer to as EBITDA. We encourage you to read our shareholder letter and our earnings release, which can be found on our Investor Relations website, as they contain important information about our GAAP and non-GAAP results, including reconciliations of historical non-GAAP financial measures. In addition, please note, we will refer to our Internet, Media & Technology segment as our IMT segment.

We will now open the call with remarks followed by live Q&A. And with that, I turn the call over to Rich.

Richard N. Barton
Thanks, Brad. Good afternoon, everyone. We appreciate you joining us today. This afternoon, we announced financial results for the third quarter and, most notably, our decision to wind down our Zillow Offers operations, which will unfortunately involve a reduction in our workforce of approximately 25% over the next few quarters.

This decision was not taken lightly, especially considering the hard work and commitment from the Zillow Offers team. But ultimately, we determined that further scaling up Zillow Offers is too risky, too volatile to our earnings and operations, too low of a return on equity opportunity and too narrow in its ability to serve our customers, a tough but necessary determination.

Before getting into the results for the quarter, I'd like to explain our logic. As you've heard numerous times from me on these calls, our vision is to help people unlock life's next chapter. We are uniquely well positioned to deliver on this vision, given our audience, our brand and our profitable and growing core business. In service of this vision, we are innovating on products and services that allow us to evolve from a search and find company to one that is
directly helping our customers transact and move. We call this Zillow 2.0 and it firmly remains our vision today.

We've made many investments towards Zillow 2.0, one of the biggest being Zillow Offers as a way to provide a compelling product offering for home sellers. When we decided to take a big swing on Zillow Offers 3.5 years ago, our aim was to become a market maker, not a market risk taker. And this was underpinned by the need to forecast the price of homes accurately 3 to 6 months into the future. We used historical data and countless simulations to test this belief. We set unit economics targets that required us to stay within plus or minus 200 basis points in breakeven, holding ourselves accountable to these levels publicly with you all.

Yet in our short tenure operating Zillow Offers, we've experienced a series of extraordinary events: a global pandemic, a temporary freezing of the housing market and then a supply-demand imbalance that led to a rise in home prices at a rate that was without precedent. We have been unable to accurately forecast future home prices at different times in both directions by much more than we modeled as possible, with Zillow Offers unit economics on a quarterly basis swinging from plus 576 basis points in Q2 to an expected minus 500 to minus 700 basis points in Q4.

Put simply, our observed error rate has been far more volatile than we ever expected possible and makes us look far more like a leveraged housing trader than the market maker we set out to be. We could blame this outsized volatility on exogenous black swan events, tweak our models based on what we've learned and press on. But based on our experience to date, it would be naive to assume unpredictable price forecasting and disruption events will not happen in the future.

Because of the price forecasting volatility, we have also had to reconsider what the business would look like at a larger scale. We have offered sellers a fair market price from the start, but
we've also been clear that the business only becomes consistently profitable at scale. With the price forecasting volatility we have observed and now must expect in the future, we have determined that the scale would require too much equity capital, create too much volatility in our earnings and balance sheet and ultimately result in a far lower return on equity than we imagined.

We have also experienced significant capacity and demand planning challenges, exacerbated by an admittedly difficult labor and supply chain environment. The combination of these factors has caused a meaningful backup in our processing of homes in the Zillow pipeline, which we announced 2 weeks ago. We judged future significant volume volatility to be a tough impediment to ramp a scaled operation, and any interruptions in the supply chain like we recently experienced will result in increased holding times, further increasing our exposure to volatility and lowering our return on equity.

A final factor in this wind-down decision is that to date, we have been able to serve only a limited number of customers. We've been able to convert only about 10% of the serious sellers who ask for a Zillow Offer, and we have tended to disappoint the roughly 90% who didn't sell to us. Given our hard-earned position at the top of the seller funnel with 220 million-plus average monthly unique users and the popularity of this estimate, there are better, broader, less risky, more brand-aligned ways of enabling all of our customers who want to move.

So these are the essential components of our wind-down logic. Our price forecasting accuracy was far more volatile than we planned for and was further exacerbated by unpredictable black swan-type events. And that volatility contributed to operational volatility and cash flow and balance sheet volatility that is beyond the tolerance level that we are comfortable with moving forward. Lastly, we believe this is an opportunity to refocus and more broadly address a wider audience of customers with more asset-light solutions.
Of course, the natural question is, what's next? Before I get there, it's worth highlighting how strong our core business is, which has thrived while we poured its profits into our ZO iBuying operation. Over that investment period, we expect IMT segment revenue to increase 57% from a reported $1.2 billion in 2018 to $1.9 billion in 2021 at the midpoint of our outlook range. Further, we expect IMT segment-adjusted EBITDA to increase by nearly 3.5x from $240 million in 2018 to $833 million in 2021 at the midpoint of our outlook range.

So we start the what's next conversation from a position of strength because of how the core business has performed. As we move forward, we remained focused on the same key areas, all with the end goal of helping turn dreamers into movers.

First and foremost, we are going to continue to create engaging experiences that attract people to our apps and sites in droves on a daily basis. Most prominently, we believe our ability to continually improve this estimate to be fundamental and foundational to our top-of-funnel audience and brand advantage.

As those that dream with us start to shop with us, we will continue to evolve our capabilities to make our shopping experience more digital and less friction-filled. Now that ShowingTime is officially part of Zillow Group, we will go to work on solving another pain point for home shoppers and agents, the cumbersome process of scheduling a tour. The touring opportunity is spiritually similar to the opportunity we pursued with our Connections program back in 2018.

Removing friction and streamlining communication between home shoppers and agents was one of our first steps towards a better and more integrated home shopping experience. We expect ShowingTime will help us enable another.
Coupled with the frictionless shopping experience must be capable partners, internal operators and seamless tools and technology to service our customers. For our Premier Agent business, that means continuing to work with high-performing partners to convert -- that convert our high-intent shoppers into movers. For Zillow Home Loans and Zillow Closing Services, that means continuing to enable integration on our moving platform.

Zillow 360 is an example of the potential golden path for our customers, a seamless move through shopping, connecting, selling, buying, financing and closing, a single place for all customers moving needs. The change necessitated by today’s announcement is the evolution of how we will help a customer sell her current home. Before today, the selling option was overly focused on Zillow Offers and was able to serve only a small number of our available customer set. Going forward, we will have the ability to plug in multiple, more scalable solutions to offer better customer choice.

Instead of a sole focus on solving the seller’s pain point by purchasing from her ourselves as the primary through Zillow Offers, we will expand our view and explore our marketplace as selling solutions that give her certainty and convenience all while addressing the broader opportunity. In solving for her move, however, we plan to focus on solutions that are asset- and capital-light for Zillow.

We can still offer choice, simplicity, speed and convenience. We will be open-minded about our exploration into providing these sell solutions ourselves and/or through partners. Both are interesting. And rather than having to buy her home to help her sell, we are now simply going to help her sell.

We are confident our current and future technology platform and tools will enable us to deliver an increasingly integrated digital and seamless experience via our own services and through partners. We continue to be in a competitively advantageous position due to our
audience, our brand and our healthy and profitable core business. We see opportunity in using our learnings from Zillow Offers, our tools and our capabilities to broaden our seller focus beyond only iBuying. Further, we look forward to using these same tools and services to increase conversion and attach rate in our large home buyer funnel.

For perspective, Zillow overall still only participates in a mid-single-digit market share of transactions today despite being used by almost every shopper, dreamer, renter, financer and mover in the country. The opportunity continues to be very large to drive growth with higher conversion and to increase the depth, number and integration of the services we offer our customers.

Before I close and hand it over to Allen, I'd like you all to know how personal this is for me. I am Founder and first money into Zillow 16 years ago and I'm the largest individual shareholder. I distinctly remember brainstorming to come up with the name of the company with my Co-Founder, Lloyd, and then buying zillow.com for $8.95 on GoDaddy all those years ago.

It weighs heavily on me that our strategic decision to wind down the Zillow Offers operation after 3.5 years involves having to let about 25% of our great colleagues go over the coming quarters. I'm sorry for how difficult and disruptive this will be. I am grateful to them. They have worked hard and will be missed. We are committed to providing a smooth transition for those affected.

The decision was tough but absolutely necessary, given the capital risk and volatility that is now obviously inherent to the Zillow Offers iBuying business. After careful assessment and volatile earnings, instead of doubling down on a single capital-constrained risk-heavy solution, we will focus on the broader problem, helping people move, and we continue the mission of having solutions that can be accessed by everyone moving, not just a narrow set of folks who
have to negotiate with us as the primary buyer, leaving most unsatisfied when we can't come to terms.

We are lucky to have a strong and growing core Marketplace business from which to invest moving forward. We are lucky to have a courageous team who have helped us on our journey and the strong culture of innovation that encourages taking big swings, but also is clear-eyed when we miss. We are lucky to have a deep untapped well of opportunity for innovation in our massive user base, partner network and trusted brands.

And finally, as a shareholder, I am lucky to have fellow investors who will appreciate both the necessity and the opportunity in this decision. Thank you. I will now turn the call over to Allen for his comments. Allen?

Allen W. Parker
Thank you, Rich. You've heard a lot about Zillow Offers, but we should not lose sight of the strong core business results we continued to produce in Q3. Zillow Group reported Q3 results for our IMT and Mortgages segments as well as Premier Agent revenue within or above our previously provided revenue and EBITDA outlook ranges. Premier Agent revenue growth of 20% year-over-year remains strong. IMT segment EBITDA margin of 43.1% was better than expected. Our Mortgages segment revenue grew 30% year-over-year to $70 million, exceeding our outlook range.

Moving into more detail. Q3 IMT segment revenue was $480 million, growing 16% year-over-year and 43% on a 2-year stacked basis compared to Q3 of 2019. Our IMT segment revenue growth continued to benefit from our Premier Agent business. We continue to execute on making better connections between our high-intent customers and high-performing agents, driving higher monetization.
Turning to other revenue within our IMT segment. Our Rentals business decelerated primarily due to a difficult comparison in Q3 as a result of abnormal seasonality in 2020. Rentals revenue also underperformed our expectations as we incurred headwinds related to high rental occupancy rates, which tempered advertising demand. IMT segment EBITDA was $207 million in Q3, exceeding our outlook. The IMT segment EBITDA margin outperformance was driven by increased operating efficiency as well as less than previously planned second half overall Zillow brand marketing spend.

Mortgages segment revenue increased 30% year-over-year in Q3 to $70 million, and Mortgages segment EBITDA was a positive $5 million compared to the midpoint of our outlook range of a loss of $9.5 million. Total loan origination volume was up 115% in Q3 year-over-year and up 25% sequentially from Q2, driven by growth in our loan originsations business. Purchase loan origination volumes was up 119% and refinance loan origination volume was up 113% year-over-year.

Now to address a few more details in our Homes segment and Zillow Offers business. We reported Q3 Homes segment revenue of $1.2 billion, below our outlook range of $1.4 billion to $1.5 billion. We reported Q3 Homes segment EBITDA loss of $381 million, below our outlook range, impacted by $304 million of an inventory write-down. The revenue miss was primarily driven by capacity constraints as we overestimated our ability to quickly scale operations in addition to industry-wide renovation labor supply constraints. This resulted in a shift in home closings into Q4 that were previously expected to close in Q3.

For clarity, I want to provide some additional details behind the inventory valuation process and the recognition and timing of losses. For inventory on our balance sheet, at period end, we compare our cost basis, our purchase price of inventory and other capitalized inventory costs to the estimated net realizable value, our estimated future selling price of those homes less estimated cost to sell.
This resulted in the recognition of a $304 million inventory write-down included in Homes segment cost of revenue in Q3. We expect to recognize additional inventory losses in Q4 of approximately $240 million to $265 million. These estimated losses primarily relate to homes that were under contract to purchase as of the end of Q3 that we expect to acquire during Q4 and that we expect to resell for less than purchased.

The Zillow Enterprise remains in a strong position with more than sufficient liquidity to weather the impact of home purchases in Zillow Offers in Q4. We ended the quarter with $3.2 billion in cash and investments. We expect the net effect of the wind-down of Zillow Offers to be at least cash flow-neutral in the aggregate.

We believe the wind-down will leave us in a strong position to invest in more scalable customer solutions that are less capital-intensive as we execute our Zillow 2.0 vision and make strategic long-term investments. Our expectation is that we will be a positive earnings and positive cash flow company with our revised product strategy once the wind-down is complete.

In addition to what I’ve just discussed, we expect the following in relation to our wind-down plan. As disclosed in the Form 8-K we filed earlier this afternoon, in addition to the inventory losses we expect to record in Q4, we expect to record additional pretax charges of approximately $175 million to $230 million related to the wind-down of Zillow Offers operations, primarily in Q4 and the first half of 2022.

These charges are expected to include certain employee retention and termination costs, cost to exit contractual obligations, including borrowing and lease arrangements and write-offs of long-lived assets. We expect unit economics to be between negative 500 to negative 700 basis
points before interest expense in Q4 as informed by our Q3 inventory write-down and Q4 outlook.

As a result of homes already under contract but not yet purchased as of the end of Q3, we expect to continue to grow our inventory balance during Q4 and then expect inventory to begin to decline in future periods. We expect to sell most of the remaining homes inventory primarily by the end of Q2 2022, with a small number of homes remaining thereafter. This implies that we will invest cash and inventory during Q4 as our inventory balance grows, and we'll begin to see cash flow back to Zillow as our inventory levels decrease through the first half of 2022.

Turning to our outlook for the fourth quarter. In our IMT segment, we expect 13% year-over-year revenue growth in Q4 and 50% growth over Q4 2019 at the midpoint of our outlook range. Within IMT segment, we expect Premier Agent revenue to be between $354 million to $362 million, up 14% year-over-year and up 53% over Q4 2019 at the midpoint of our outlook. We expect Q4 IMT EBITDA margin to be 42% at the midpoint of our outlook, roughly flat sequentially from 43% in Q3.

Our outlook includes our plans to continue to invest in staffing and technology in Q4 to drive our 2.0 vision, including things like touring, bundling products such as Zillow 360, expanding 3D photos and floor plans along with continuing to invest in integrating Zillow 2.0 products.

Separately, we closed our acquisition of ShowingTime on September 30, which will be included in our IMT segment results beginning in Q4. We are beginning to integrate ShowingTime's platform and are excited about the opportunity to better serve our customers and partners. We plan to invest further in innovating ShowingTime's solutions to better serve the entire industry.
In Q4, we expect our Homes segment revenue to be between $1.9 billion -- we expect Homes segment revenue to be $1.9 billion and EBITDA to be a loss of $348 million at the midpoint of our outlook range. As I mentioned earlier, we expect to record an additional loss in Q4 of between $240 million and $265 million primarily related to the homes under contract to purchase as of the end of Q3 that we expect to purchase in Q4.

During Q4, given our resale capacity constraints, we expect our inventory balance to grow and then decline beginning in Q1 of 2022. We expect there could be a wide array of results in Q4 for our Homes segment as we work to free up operational and renovation capacity and pursue various resale strategies as we seek to protect the value of our assets and optimize our wind-down while respectfully managing our people.

We expect our Mortgages segment revenue to be between $47 million to $52 million in Q4, which is down sequentially from Q3. Our Q4 outlook reflects slower industry refinance activity from the recent move in interest rates, slight compression in gain on sale spreads and slower growth in purchase originations impacted by the wind-down of Zillow Offers operations. As a result of lower sequential revenue and continued investments to grow mortgage originations, we expect Mortgages segment EBITDA to be between a loss of $16 million and $11 million in Q4.

While we are in the midst of 2022 planning, we wanted to share that we are focused internally on continuing to drive secular growth faster than the industry. We do want to highlight that during 2021, our Premier Agent business has outgrown the industry in each quarter and expect the business to continue to do so in our Q4 outlook. While there are near-term cyclical pressures on some of our other Marketplace businesses, we are hard at work with initiatives to drive growth regardless.
We are also well positioned with our strong traffic in our other IMT marketplaces to benefit as rental and new construction supply and demand imbalances normalize and when these advertising pressures subside. We have a large audience but a significant growth opportunity with only approximately mid-single-digit market share of industry transactions. Progress on improving connections and showings as well as the customer dream, shop, buy, sell, rent and finance experiences are among the numerous tangible initiatives we are delivering to continue to drive secular growth to connect more high-intent customers with a growing mix of high-performing partners.

As we look forward, my priorities remain focused on innovating and executing on behalf of our customers and partners, and I look to ensure an orderly wind-down of Zillow Offers operations, rightsize our cost structure and improve productivity to drive a profitable, scalable and positive cash flow company, drive prioritization to invest in sustainable top line growth opportunities across the company, including new integrated services that are more scalable, less subject to earnings volatility and more capital efficient.

And with that, operator, we'll open the line for questions.

**Question and Answer**

**Operator**

Our first question today comes from Brad Erickson with RBC Capital Markets.

**Bradley D. Erickson**

So a couple of questions. One, I recognize, Rich, you've explained things in the shareholder letter and on TV a few minutes ago. But I think people really want to understand just the mechanics maybe a bit better of what went wrong here, particularly in the bidding. So let's start there, and then I have a follow-up.

**Richard N. Barton**
Yes. Brad, thanks for the question. We were -- fundamentally, we have been unable to predict future pricing of homes to a level of accuracy that makes this a safe business to be in. We hadn't modeled this kind of pricing market nor supply market to even be possible when we got the business going. And we've seen all this volatility in both directions right now in the wrong direction.

And we're still at a scale that is small compared to what it needs to be. And so as we put our minds in the state of, all right, we've got these new assumptions that we'd be naive not to assume will happen again in the future, we pump them into the model and the model cranks out a business that has a high likelihood, at some point, of putting the whole company at risk, not just the business, but in the more normal case, just causes a ton of volatility in earnings, which is not a great look for a public company.

That's -- basically, that's what it boils down to. There's capacity issues, et cetera, that we can talk about, that we've had internally and externally on the backdrop of a really tight environment. What it boils down to is our inability to have confidence in pricing in the future, enough confidence to put our own capital at risk then we don't have to.

**Bradley D. Erickson**

Got it. And then I guess the follow-up is you mentioned looking to expand solutions to work with sellers in different ways despite no longer doing iBuying. So I guess the question is, can you just, I guess, expand on some of those tools that you might engage with for those sellers with this new shift in strategy?

**Richard N. Barton**

Yes, okay. So most -- I don't want to say all, it's probably not all, but it's certainly most sellers in the market, even when they're at the very early stages of selling, maybe we'll call it dreaming, transitioning to selling, they show up in our apps. They look at their estimate. They
start talking to people. They start looking at comps and consuming information. We have a lot of very interesting, highly engaged touch points that -- with these customers.

And we've learned a whole lot about transitioning that life touch into a conversation. In doing Zillow Offers, we've learned a ton about that. And so whether the front door is through the Zestimate or through a request for prequalification or looking for an agent or just wanting advice, we have a lot of ways to take a customer conversation from a kind of a shallow one to an advisory conversation.

And we look forward to being able to now refocus more broadly on that, that set of customers rather than basically having one really, really having the organization and all our profits from the core business focused on that one thing to sell in the store. We only have kind of one thing to sell in the store in our iBuying operation. This is going to free us up from having to think so narrowly. We think that these are still interesting solutions, but it frees us up from having to think so narrowly and we can capitalize on a broader opportunity.

Operator
Our next question comes from Ryan McKeveny with Zelman & Associates.

Ryan McKeveny
Rich, I want to focus again on kind of the what's next for Zillow. So if I just think about the evolution to Zillow 2.0 and the efforts to build a more integrated experience, obviously, the last few years, iBuying has been a big piece of that, longer-term vision of getting the Zestimate effectively to a live bid. And to Brad's question, you mentioned being committed to creating that integrated experience still, solving pain points, doing so asset and capital light.

I guess just asked slightly differently, I mean, big picture, Zillow has always been mainly a platform that's monetized the buy side. And I think a lot of people looked at iBuying and said,
this is opening up that sell-side opportunity. So maybe it's the same question twice, but how
does this play out on the sell side going forward? What's next in that regard? What's the
strategy to really drive this so it's not just viewed to be a buy-side monetization vehicle and
really capture what should be a significant opportunity on the sell side?

Richard N. Barton

Yes. Thanks for the question, Ryan. I'll -- I won't just give the same answer, but it's -- there is a
much more interesting scope of an answer and your focus on unlocking the sell side is where
I'll land or I'll start and then Allen or anyone can jump in. But look, our dream of basically
making the transaction a lot easier breaks down into -- for sellers who are moving, breaks that
down into a whole lot of pain point components, okay? And those pain points that we're
trying to use our technology to solve for start with simply shopping on the site and looking at
listings.

And one of the big things that we have invested a lot of people and R&D in is making that
shopping experience much more immersive 3D, digital floor plans and giving shoppers a much
more realistic sense for what the home is like. So we have a big investment there and that
kind of came from this effort. We just closed the ShowingTime acquisition, which is a way for
us to look at creating a touring reservation system. This is another big pain point for movers
and shoppers when they're just trying to arrange to go see homes in the flesh.

And with ShowingTime, we have an opportunity to turn that into a much better experience
and give us a chance to actually sell some things to those customers who are in that process,
which is a really interesting opportunity.

Next, the mover, the seller might want to pre-qual for the next mortgage or get a mortgage.
Next, we want to route documents and do closings and title and escrow all integrated into the
same fluid experience. So we have invested in -- those are just a few of the steps. But we've --
because of our -- because of Zillow Offers and our focus on the sell side of the market that you're talking about, we have invested in each one of those components and with our technology, we have an opportunity to stitch these things together in a way that very few are going to have the opportunity to do it.

So the seller -- the Rubik's Cube of unlocking the seller is a really interesting challenge. It turns out that a whole bunch of buyers are sellers, too, so there is a pretty heavy overlap between buyers and sellers. And we firmly believe focusing on the transaction will provide a ton of growth for us.

Allen W. Parker

I'll just touch on that, most sellers are buyers. One of their friction points is freeing up equity in their current home. Obviously, iBuying provided an opportunity for that with us as a counterparty purchasing the home, but there are a lot of other proptech and opportunities for us to look at ways to free up that equity and help that seller move into their next home that are less capital-intensive and can provide that seller with possibly more value as they list their home but with similar certainty or at least less friction.

So we believe that there will be quite a few different call to action to help sellers as they dream into that next home but just that are not the counterparty of us negotiating with that seller only. And as Rich mentioned, only about 10% of those sellers actually took our offer.

Ryan McKeveny

Got it, okay. And my second question, I just want to clarify what you're saying about the overall kind of macro home price environment. So most of the measures that are out there of CoreLogic Case-Shiller or any of the home price indices, generally, it seems to be an environment where price is still going up, albeit at a much slower pace than what had been happening.
So I guess to take a step back to the macro side of things, you talk a lot about the volatility and the unit margin swing. I just want to make the question, how much of that is related to, again, the forecasting side of things potentially being too optimistic versus a very volatile swing in natural prices within the broader housing market at this point?

Richard N. Barton
It was -- forecasting volatility, Ryan, is the short answer.

Allen W. Parker
Yes, the way I would describe it, Ryan, is that as we came into the first half of the year and then into the second half and we made the decision to go ahead and grow, given our Q1 performance, we made a decision that we needed to increase our acquisition pace, and we -- and our models -- our forecasting process, I should say, at that time, was not keeping up with that rapid rate of HPA increase that was occurring.

And as we went into the second half of the year, HPA still continues to increase and we believe that there's still a strong market but the rate of increase declined significantly. So there was this volatility that Rich talked about that was way outside of the normal distribution you would expect. And that's where I think our pricing forecasting accuracy was less than we had expected. The volatility was higher, maybe it's another way of saying it.

And so we still believe that the -- and I could talk more about the write-down, but the assets are valuable, the market's still strong, but we ended up with that volatility agreeing to prices that are going to be higher than what we expect to sell those houses for less selling cost.

Operator
Our next question comes from Brent Thill with Jefferies.
Brent John Thill
Rich, you're blessed with a really high-margin IMT business, and many have asked the sustainability of that margin profile going forward. Can you talk to what this environment does, if anything, to the margin profile of that core business as we head into '22?

Allen W. Parker
Rich, do you want me to start with that and you can jump in?

Richard N. Barton
Yes, please, Allen. Thank you.

Allen W. Parker
Yes. So as we reported coming out of the pandemic in the second half of 2020 and then coming into the first half of '21, we've seen margins that have been in the 46%, 47% range. I think at the midpoint of our outlook this year, 44% is our margin rate for IMT. 42% is the margin rate for this quarter. We think the 42%, 43% margin rates are durable, tight margins.

And that's with a level of investment that still allows us to do some of the things I talked about in my prepared remarks in terms of touring and continuing to drive higher-intent customers to high-performing agents.

When I look at the IMT business and I look at the growth opportunities, again, we participate in a very small number of transactions. We continue to make progress on connecting these customers to high-performing agents and improving conversion and so there's a lot of opportunity for growth. We believe we can leverage that growth, which is why I feel comfortable that some of those margin rates are durable going forward.
I do think we'll reserve the right, over time, to invest because we're long-term focused, not just short-term focused. But these margin rates of 40% to 42%, in that range, I believe, are durable margin rates for this business. And I believe that the top line, as we mentioned, we believe can continue to grow faster than the industry.

Richard N. Barton
Well said, Allen.

Brent John Thill
Great. And can I follow up one with Rich? Just last quarter, we all heard you kind of commit and say you had increasing support for the business in that every quarter that passed, you had more conviction. And then all of a sudden, the record scratches this quarter and we understand that things change.

But what was it versus last quarter to now that really changed your perspective? Was there 1 or 2 events that triggered? Or just -- I think everyone was trying to reconcile what you said last quarter to what just happened and sort of go back as well on that, but I want to make sure we truly understand what you were meaning there.

Richard N. Barton
Well, extraordinary volatility in our earnings and this big markdown on a relatively low volume of units, coupled with us running into internal and external kind of capacity and labor constraints basically brought into high relief and forced us to recognize the inherent risk that exists in the iBuying operation. It's almost as simple as that.

I mean, we could have -- we could solve our forecasting problems in most markets, for sure, and we can solve our operations problems. But what we can't solve is what the model is going to tell us about how much capital we need to raise, deploy and risk in the future in order to
achieve a scale that we think is necessary to offer a fair price to customers for their homes in a competitive way.

We have been offering a fair price now while we've learned the business, but in order to get the scale economies, we have to get a lot bigger. So the score has changed a lot this quarter, but if we're 10x, 20x the size we are now, it's just -- it doesn't compute.

And look, that's what happened. And luckily, our calculus is different. We built Zillow Offers on top of an incredibly strong core business that has grown tremendously while we've been taking a big swing on Zillow Offers. And it's that strong core business that gives us such an enviable position in the upstream in the customer funnel.

That's what happened. It's not actually all that complicated logically. It is complicated emotionally because of the people ramifications of our decision to wind it down. So that's where it gets you.

Operator

Our next question comes from Mark Mahaney with Evercore ISI.

Mark Stephen F. Mahaney

Two questions, please. First, do you think that there's any change in dynamics with real estate agents? Was that at all a factor in your decision? And getting out of the Zillow Offers, would you expect that to have any impact on relations with professional real estate agents across the industry? And then secondly, just talk -- double-click on the mortgages business and the path to potential robust profitability or if there is a path and how you get there.

Richard N. Barton

Do you want me to start, Allen?
Allen W. Parker

Yes.

Richard N. Barton

Okay. We have a really large partner network in our agents, Mark, as you know. We have helped them really -- have helped the ones who partner with us and get on board with our program to really drive their businesses. So we've had great relationships with them. We continue to -- some may see this as a sign of one thing or another. But honestly, we're really focused on innovating for customers and bringing new customer solutions to market. And as long as we're doing great things for customers, we know that partners will be there to be with us. So that's kind of how we think about that. The second part of the question, Allen, maybe?

Allen W. Parker

Yes, I can take that, Mark. And I guess what I'd say is that we're glad that we have the ZHL mortgage business and mortgage marketplace business. We built the factory over the last 2.5 years or so initially off of refinancing and we showed that we can close loans on time and satisfy customers. And we have shown our ability to be profitable with enough volume.

Now as we came into '21 and the refi volume slowed down, when the volume goes down below a certain level, we start to see this investment we're making in our loan purchase originations business show through as investment versus profit. But as shown in Q3, $70 million of revenue, 32% of our funded loans were purchased, that's up 600 basis points from the quarter prior.

Now 70% of those were leads from the Zillow Offers business. That gives us comfort that financing is a very important part of the moving process and that having a financing factory
that could help serve our customers in a variety of ways is a capability that we must have as we think about serving our customers as they move.

And that as we get volume, we're able to generate profitability that you would expect from a purchase company or, I should say, a mortgage origination company as that volume grows. So we may see a little bit of choppiness as we go into Q4 and Q1, but there's a lot of opportunities for us to present and provide our customers with pre-qualification and eventually pre-approval and to work with our partner base in using our ZHL as the loan origination. And so we're, Rich, you can add anything, but we're excited to have this capability.

Richard N. Barton

That was really a thorough answer. I mean, maybe one summary point, and just to remind investors that we do collect a ton of mortgage interest from consumers right now because of our way up-funnel position. And we process only a small portion of that ourselves with ZHL, and we have a marketplace for the balance of them, that's -- this puts us in a really good position to innovate here.

Operator

Our next question comes from Ygal Arounian with Wedbush Securities.

Ygal Arounian

First question, understanding the difficulty in pricing and forecasting. The way you're talking about Zillow Offers is really different than how you've talked about it in the past, that it serves a narrow part of your customers. And what you've talked about in the past is really a central piece to the puzzled offering, a central piece to Zillow 360, expecting it to drive partner leads, expecting it, as Allen just mentioned, on purchase originations on the mortgage side.
So it does feel like there's a little bit of a hole here in the middle of the vision. Can you just -- I know you've talked about it, but maybe like why is there not a hole in the vision with the iBuyer business now pulled out of it?

And then the second question, since now, I guess, where there will be a lot more focus on Premier Agent, and you've talked a lot about the high-performing agents and connecting them with high-converting customers. Can we get a little bit more color around that? What's changed? What's changing? How that's benefiting and how that will continue to kind of benefit as we get into next year?

Richard N. Barton

Okay. Hopefully, you took some notes, Allen...

Allen W. Parker

I did. Maybe you could just talk about the first question is, again, what's next, I think.

Richard N. Barton

Yes, yes. I mean, we've talked about it a couple of times but maybe I'll go into a little bit more subtle point, Ygal, that maybe is not as obvious. I tried to say it in my script, but being in a position where we are having to negotiate with sellers about their most important asset and the most important thing they own in their lives emotionally and financially, and being put in a position of being the primary to negotiate with them on that and to have 90% of them approximately go do something else, some of them pretty miffed about the brand, is not what we're used to. It's not what we're trying to be. It's not what the history of our brand has been.

And so there is -- a little bit of what's in here is how -- what has been emerging is that it's been a little bit too narrow of a solution. The ends aren't that big either, but that is a little bit of what's going on here. I also -- you've been looking for, for many quarters, us to draw a straight
hard, solid lines to seller leads from that interaction. And we've said we're making progress. We're trying things. We're improving. But it hasn't been a big business driver for us so far, some of which because of the subtle interactions that I was talking about.

Having this be the only thing we're selling to sellers was -- has been the realization we've made is that, that is limiting and that being able to have a larger, broader menu of things to offer our sellers is what we want to be able to focus on. We think we can serve a lot more people that way. And you don't need to look much further than a ton of kind of venture capital proptech investment that is going into the space trying to address this same kind of problem in a more asset-light way. So we think there's a lot of potential here but in ways that don't force us to put our whole balance sheet at risk. The second part of the...

Allen W. Parker

Yes, maybe I'll take the second part. So it was about, how do we feel about, I guess, higher-performing agents and getting them higher-intent customers, what are the drivers there, I believe? Is that a fair representation of the question?

Ygal Arounian

Yes. And obviously, it feels like that's a driver of PA and you're not...

Allen W. Parker

Yes. And so I guess what I talked about is -- yes. What we look at when we look at the opportunities in our Premier Agent business is high-intent customers and there are actions that customers take which are more sticky than others. For example, touring is a great example of as we invest and develop the touring technology, especially with ShowingTime now part of the Zillow Group, we believe that those actions to schedule a tour generate a higher-intent customer that we can connect with an agent in a much more friction-free basis with a higher actual face time connection.
3D homes and floor plans allow our customers to engage in a variety of different homes and then pick the ones they want and so they're higher intent. Zillow 360 and a lot of these discussions we're having about what -- how do we drive an integrated transaction with ZHL and sellers or buyers who need financing when they're buyers or need to free up equity when they're sellers of an old home and want to buy.

All of these things, as we think about moving forward in Zillow 2.0, are going to generate additional, as Rich mentioned, partner leads that are coming off of other channels or other areas of our funnel, then the current channel, which right now is HDP submits that we have that then turn into connection.

So we continue to get better about monetizing our current traffic and transactions, but we're also investing and developing tools and technologies that create higher-intent, slightly stickier actions that get our customers to agents in a way that are driving conversion up and we get paid for that either in as part of a return on the ROI through MVP or through just number of transactions based on conversion rates with a flex transaction, if that helps. Would you add anything, Brad or Rich?

**Richard N. Barton**

That was great.

**Operator**

Our last question today comes from Andrew Boone with JMP Securities.

**Andrew M. Boone**

Two, please. So the first, just on Zillow Offers. It felt like it was a key on-ramp for Zillow 360. Can you talk about your vision for Zillow 360 through just PA?
And then for number two, Rich, iBuying, to some, felt like a defensive move initially. To that end, where do iBuying fit into your vision of real estate more broadly? And is this now something that's just too narrow for an over base? Or is it simply put, as you've mentioned multiple times, just not the best use of Zillow's capital? So kind of where is the end state of iBuying?

Richard N. Barton

Andrew, it's early days for Zillow 360 -- excuse me, I just swallowed my cough drop. I'm back.

Yes, it's early days for Zillow 360. We have been doing a lot of testing of it. Zillow Offers has been a part of it for some, but just a part. And we actually think being able to slot many different choices for unlocking sellers as a part of Zillow 360 is a good opportunity.

Most interestingly, we're assembling all these other components, all these other ingredients that we've built to make this integrated experience better. But it is -- it's early days, so talking about it more than that would be, I think, is premature. Anything to add on that, Allen?

Allen W. Parker

Well, no, I'd just say that it was always broader than just iBuying being the only source. ZHL and PA are example and Closing Services are an example of services that we can bundle together. It was really a concept of bundling together more than one service, and we were not always -- it didn't always have to be iBuying. So it's still a concept that I think we've seen improved conversion when we've been able to offer customers integrated services in a package and leverage the lower CAC.

Richard N. Barton
As for the back half of your question, Andrew, it's really hard to say. We can only kind of talk about this in the context of our calculus, the amount of risk and equity and balance sheet we're willing to take. We were -- we have been willing to take a really big swing on this but not a bet-the-company swing.

There was a potential defensive motivation in going into it in the first place, but we feel after 3.5 years of experience with it, we feel really confident in our offensive position without having to be the primary ourselves. I guess that's how I would answer that, Andrew. And is that it, Brad?

**Bradley Allen Berning**

I think that was it. Operator, is that correct?

**Richard N. Barton**

Yes. Okay. I'll wrap it up. Zoom life. I'll wrap it up. Thanks. Thanks, everybody, for your time.

Look, similar to other leading technology companies that have gone before us, we strongly believe in taking big swings and failing fast. We have learned from our experience in Zillow Offers in Q3 and are applying those learnings as we look ahead. We continue -- as you can hear, we continue to be excited about the opportunity we see in front of us, and we look forward to speaking with you next quarter.

Okay, operator, we can conclude the call. Thank you all very much.

**Operator**This concludes today's conference call. You may now disconnect.
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