Is Zillow Group Worth Buying After Last Month's Drop?

Description

Shares of **Zillow Group** (NASDAQ: Z)(NASDAQ: ZG) fell more than 30% in August after the online real estate platform specialist announced strong second-quarter 2019 results, but followed with underwhelming forward guidance.

The bulk of Zillow's losses last month came in the *two days* following its Aug. 7 update, when the company told investors that quarterly revenue had soared 84% year over year to $599.6 million, translating to an adjusted net loss of $0.14 per share. By contrast, most analysts were looking for a slightly larger net loss on lower revenue of $585 million.

So what gives? And perhaps more important for investors today, is Zillow stock worth buying after the drop?

Perspective is in order

Zillow's legacy Premier Agent business saw revenue climb only 0.5%, to just under $232 million this quarter — which, to be fair, was close to the high end of Zillow's guidance. Traffic to Zillow Group's mobile apps and websites also climbed 4% year over year, to over 194 million monthly unique users, and its number of total visits climbed 14%, to almost 2.2 billion.

But Zillow's top-line growth was largely driven by its newer "homes" segment, which generated sales of $248.9 million during the quarter, well above guidance for a range of $230 million to $245 million. And Zillow noted that consumer awareness for its Zillow Offers program is gaining steam: Over 69,000 homeowners requested an offer from Zillow to buy their homes during the quarter (up 94% sequentially from Q1), helping the program reach an annualized revenue run rate of more than $1 billion within its first year.

Of course, that revenue hasn't turned into profits just yet. After accounting for costs related to acquisition, renovations, holding, and selling, Zillow actually lost an average of just over $2,900 on each of the 786 homes it sold this quarter.

But that should change as Zillow rapidly grows its homes business and enjoys greater economies of scale. To that end, Zillow added seven new Zillow Offers markets in the second quarter alone, expanding to Dallas-Fort Worth, Minneapolis, Portland, Nashville, Orlando, and the Colorado Springs/Fort Collins areas. And by the middle of next year, it plans to launch Zillow Offers in Cincinnati, Tuscon, Jacksonville, and Oklahoma City.

“Early stages of a bold expansion”

For perspective, recall that over the longer term, Zillow management has told investors they see the company purchasing as many as 5,000 homes per month, which should, in turn, help feed at least 3,000 mortgage loans per month (assuming a 33% attach rate) through its budding mortgages segment.

“We’re in the early stages of a bold expansion of our company that opens up exciting opportunities for our customers, partners, shareholders and employees,” added Zillow co-founder and CEO Rich Barton. “We are uniquely advantaged by our brand awareness, audience size, technology, data science, industry partnerships, and operational know-how and are well on our way to rewire real estate.”

Looking ahead to the full year, however, Zillow told investors last month to expect Premier Agent revenue of $900 million to $915 million, up around 1% at the midpoint but marking a reduction from its old target range of $910 million to $930 million. That modest growth can be partly attributed to Zillow’s new “Flex” monetization model, which allows Premier Agents to pay a fee only when they close a transaction with a consumer lead rather than paying for ads upfront. The company also declined to provide a 2019 outlook for that early-stage homes segment, opting instead to prioritize scaling the business as quickly as possible.

The end result? After rallying more than 60% year to date leading up to its quarterly report, Zillow effectively gave up most of that gain over the past month as traders panned its lack of profitability and sluggish Premier Agent revenue growth.

But if Zillow can manage to over deliver and show it has what it takes to generate sustained, profitable growth over the long term from each of its core segments — led by the massively disruptive homes segment — I think now could be a perfect time to pick up the stock before the rest of the market realizes its potential.

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