ZILLOW GROUP, INC.
Form 10-Q
May 04, 2016
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT 1934**

For the quarterly period ended March 31, 2016

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 001-36853

ZILLOW GROUP, INC.

(Exact name of registrant as specified in its charter)

Washington	**47-1645716**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
1301 Second Avenue, Floor 31, Seattle, Washington	**98101**
(Address of principal executive offices)	**(Zip Code)**

(206) 470-7000

@ZillowGroup

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of April 26, 2016, 53,521,388 shares of Class A common stock, 6,217,447 shares of Class B common stock, and 119,398,302 shares of Class C capital stock were outstanding.

Table of Contents

ZILLOW GROUP, INC.

Quarterly Report on Form 10-Q

For the Three Months Ended March 31, 2016

TABLE OF CONTENTS

Table of Contents

As used in this Quarterly Report on Form 10-Q, the terms Zillow Group, the Company, we, us and our refer to Z
Group, Inc., unless the context indicates otherwise.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including Part I, Item 2 (Management s Discussion and Analysis of Financial Condition and Results of Operations), contains forward-looking statements based on our management s beliefs and assumptions and on information currently available to our management. Forward-looking statements include all statements that are not historical facts and generally may be identified by terms such as believe, may, will, estimate, continue, anticipate, intend, could, would, project, plan, expect or the negative or plural of these words expressions.

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including but not limited to our ability to successfully integrate and realize the benefits of our past or future strategic acquisitions or investments, including our February 2016 acquisition of Naked Apartments, Inc., as well as those risks, uncertainties and assumptions described in Part 1, Item 1A (Risk Factors) in our Annual Report on Form 10-K for the year ended December 31, 2015. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the effect of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely on forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Moreover, except as required by law, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements, and we undertake no obligation to update publicly any forward-looking statements for any reason after the date of this report to conform these statements to actual results or to changes in our expectations.

WHERE YOU CAN FIND MORE INFORMATION

Our filings with the Securities and Exchange Commission, or SEC, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports are available on our website at www.zillowgroup.com, free of charge, as soon as reasonably practicable after the electronic filing of these reports with the SEC. The information contained on our website is not a part of this quarterly report on Form 10-Q or any other document we file with the SEC.

Investors and others should note that Zillow Group announces material financial information to its investors using its press releases, SEC filings and public conference calls and webcasts. Zillow Group intends to also use the following channels as a means of disclosing information about Zillow Group, its services and other matters and for complying with its disclosure obligations under Regulation FD:

Zillow Group Investor Relations Webpage (http://investors.zillowgroup.com)

Zillow Group Investor Relations Blog (http://www.zillowgroup.com/ir-blog)

Zillow Group Twitter Account (https://twitter.com/zillowgroup)

The information Zillow Group posts through these channels may be deemed material. Accordingly, investors should monitor these channels, in addition to following Zillow Group s press releases, SEC filings and public conference calls and webcasts. This list may be updated from time to time. The information we post through these channels is not a part of this quarterly report on Form 10-Q or any other document we file with the SEC, and the inclusion of our website addresses and Twitter account are as inactive textual references only.

1

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

ZILLOW GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data, unaudited)

	March 31, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 232,443	$ 229,138
Short-term investments	281,218	291,151
Accounts receivable, net of allowance for doubtful accounts of $3,119 and $3,378 at March 31, 2016 and December 31, 2015, respectively	32,270	29,789
Prepaid expenses and other current assets	21,006	24,016
Total current assets	566,937	574,094
Restricted cash	1,053	3,015
Property and equipment, net	92,839	89,639
Goodwill	1,919,777	1,909,167
Intangible assets, net	549,267	554,765
Other assets	5,380	5,020
Total assets	$ 3,135,253	$ 3,135,700
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 4,995	$ 3,361
Accrued expenses and other current liabilities	46,434	43,047
Accrued compensation and benefits	20,185	11,392
Deferred revenue	24,749	21,450
Deferred rent, current portion	1,203	1,172
Total current liabilities	97,566	80,422
Deferred rent, net of current portion	13,704	13,743
Long-term debt	230,000	230,000
Deferred tax liabilities and other long-term liabilities	132,528	132,482
Total liabilities	473,798	456,647
Commitments and contingencies (Note 14)		
Shareholders equity:		

Preferred stock, $0.0001 par value; 30,000,000 shares authorized as of March 31, 2016 and December 31, 2015; no shares issued and outstanding as of March 31, 2016 and December 31, 2015		
Class A common stock, $0.0001 par value; 1,245,000,000 shares authorized as of March 31, 2016 and December 31, 2015; 53,495,119 and 53,299,111 shares issued and outstanding as of March 31, 2016 and December 31, 2015, respectively	5	5
Class B common stock, $0.0001 par value; 15,000,000 shares authorized as of March 31, 2016 and December 31, 2015; 6,217,447 shares issued and outstanding as of March 31, 2016 and December 31, 2015	1	1
Class C capital stock, $0.0001 par value; 600,000,000 shares authorized as of March 31, 2016 and December 31, 2015; 119,326,718 and 118,958,359 shares issued and outstanding as of March 31, 2016 and December 31, 2015, respectively	12	12
Additional paid-in capital	2,985,478	2,956,111
Accumulated other comprehensive income (loss)	169	(471)
Accumulated deficit	(324,210)	(276,605)
Total shareholders equity	2,661,455	2,679,053
Total liabilities and shareholders equity	$ 3,135,253	$ 3,135,700

See accompanying notes to condensed consolidated financial statements.

2

Table of Contents

ZILLOW GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data, unaudited)

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Revenue	$ 185,982	$ 127,273
Costs and expenses:		
Cost of revenue (exclusive of amortization) (1)	16,452	13,019
Sales and marketing	98,760	59,286
Technology and development	64,417	37,325
General and administrative	53,837	38,024
Acquisition-related costs	593	12,477
Restructuring costs		25,065
Total costs and expenses	234,059	185,196
Loss from operations	(48,077)	(57,923)
Other income	681	269
Interest expense	(1,573)	(730)
Loss before income taxes	(48,969)	(58,384)
Income tax benefit	1,364	
Net loss	$ (47,605)	$ (58,384)
Net loss per share basic and diluted	$ (0.27)	$ (0.40)
Weighted-average shares outstanding basic and diluted	178,686	147,390

(1) Amortization of website development costs and intangible assets included in technology and development	$ 20,059	$ 11,782

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

ZILLOW GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands, unaudited)

	Three Months Ended March 31,	
	2016	**2015**
Net loss	$ (47,605)	$ (58,384)
Other comprehensive income:		
Unrealized gains on investments	641	149
Reclassification adjustment for net gains from investments included in net loss	(1)	(10)
Net unrealized gains on investments	640	139
Total other comprehensive income	640	139
Comprehensive loss	$ (46,965)	$ (58,245)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

ZILLOW GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Operating activities		
Net loss	$ (47,605)	$ (58,384)
Adjustments to reconcile net loss to net cash provided by operating activities, net of amounts assumed in connection with acquisitions:		
Depreciation and amortization	23,807	14,028
Share-based compensation expense	25,551	23,007
Restructuring costs		21,702
Release of valuation allowance on certain deferred tax assets	1,364	
Loss on disposal of property and equipment	1,436	87
Bad debt expense	313	805
Deferred rent	(7)	381
Amortization of bond premium	430	849
Changes in operating assets and liabilities:		
Accounts receivable	(2,770)	(296)
Prepaid expenses and other assets	2,708	5,477
Accounts payable	1,594	(763)
Accrued expenses and other current liabilities	2,793	(7,652)
Accrued compensation and benefits	8,759	1,727
Deferred revenue	3,294	112
Other long-term liabilities	(2,749)	375
Net cash provided by operating activities	18,918	1,455
Investing activities		
Proceeds from maturities of investments	44,108	63,780
Purchases of investments	(38,760)	(59,896)
Proceeds from sales of investments	4,795	4,979
Decrease in restricted cash, net of amounts assumed in connection with an acquisition	1,962	147
Purchases of property and equipment	(15,212)	(10,321)
Purchases of intangible assets	(1,714)	(284)
Cash acquired in acquisition, net		173,406
Cash paid for acquisition, net	(12,357)	
Net cash provided by (used in) investing activities	(17,178)	171,811
Financing activities		
Proceeds from exercise of stock options	1,682	9,124
Value of equity awards withheld for tax liability	(117)	(303)

Net cash provided by financing activities	1,565	8,821
Net increase in cash and cash equivalents during period	3,305	182,087
Cash and cash equivalents at beginning of period	229,138	125,765
Cash and cash equivalents at end of period	$ 232,443	$ 307,852
Supplemental disclosures of cash flow information		
Noncash transactions:		
Value of Class A common stock issued in connection with an acquisition	$	$ 1,883,728
Capitalized share-based compensation	$ 2,250	$ 2,424
Write-off of fully depreciated property and equipment	$ 6,834	$ 11,759

See accompanying notes to condensed consolidated financial statements.

Table of Contents

ZILLOW GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Organization and Description of Business

Zillow Group, Inc. operates the leading real estate and home-related information marketplaces on mobile and the Web, with a complementary portfolio of brands and products to help people find vital information about homes and connect with local professionals. Zillow Group s brands focus on all stages of the home lifecycle: renting, buying, selling, financing and home improvement. The Zillow Group portfolio of consumer brands includes real estate and rental marketplaces Zillow, Trulia, StreetEasy, HotPads and Naked Apartments. In addition, Zillow Group works with tens of thousands of real estate agents, lenders and rental professionals, helping maximize business opportunities and connect to millions of consumers. We also own and operate a number of brands for real estate, rental and mortgage professionals, including DotLoop, Mortech, Diverse Solutions and Retsly.

Certain Significant Risks and Uncertainties

We operate in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, we believe that changes in any of the following areas could have a significant negative effect on us in terms of our future financial position, results of operations or cash flows: our ability to successfully integrate and realize the benefits of our past or future strategic acquisitions or investments, including our February 2016 acquisition of Naked Apartments; rates of revenue growth; engagement and usage of our products; scaling and adaptation of existing technology and network infrastructure; competition in our market; management of our growth; qualified employees and key personnel; protection of our brand and intellectual property; changes in government regulation affecting our business; intellectual property infringement and other claims; protection of customers information and privacy concerns; and security measures related to our mobile applications and websites, among other things.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements include Zillow Group, Inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the audited financial statements and accompanying notes as of and for the year ended December 31, 2015 included in Zillow Group, Inc. s Annual Report on Form 10-K, which was filed with the SEC on February 12, 2016. The condensed consolidated balance sheet as of December 31, 2015, included herein, was derived from the audited financial statements of Zillow Group, Inc. as of that date.

We have retroactively adjusted prior period share and per share amounts in our condensed consolidated financial statements for the effect of the August 2015 distribution of shares of our Class C capital stock as a dividend to our Class A and Class B common shareholders so that prior periods are comparable to current period presentation.

Effective February 17, 2015, Zillow Group acquired Trulia, Inc. (Trulia), and each of Zillow and Trulia became wholly owned subsidiaries of Zillow Group. For financial reporting and accounting purposes, Zillow was the acquirer of Trulia. The results presented in the Condensed Consolidated Financial Statements and the Notes to Condensed Consolidated Financial Statements reflect those of Zillow prior to the completion of the acquisition of Trulia on February 17, 2015, and Trulia s results of operations have been included prospectively after February 17, 2015. Market Leader revenue is included in our results of operations from February 17, 2015 through the date of divestiture of September 30, 2015.

The unaudited condensed consolidated interim financial statements, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial position as of March 31, 2016, our results of operations and our cash flows for the three month periods ended March 31, 2016 and 2015. The results of the three month period ended March 31, 2016 are not necessarily indicative of the results to be expected for the year ended December 31, 2016 or for any interim period or for any other future year.

Table of Contents

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, website development costs, recoverability of long-lived assets and intangible assets with definite lives, share-based compensation, income taxes, business combinations and goodwill, among others. To the extent there are material differences between these estimates, judgments, or assumptions and actual results, our financial statements will be affected.

Recently Issued Accounting Standards

In March 2016, the Financial Accounting Standards Board (FASB) issued guidance on several aspects of the accounting for share-based payment transactions, including the income tax consequences, impact of forfeitures, classification of awards as either equity or liabilities and classification on the statement of cash flows. This guidance is effective for interim and annual reporting periods beginning after December 15, 2016, and early adoption is permitted. We have not yet determined our approach to adoption or the impact the adoption of this guidance will have on our financial position, results of operations or cash flows.

In February 2016, the FASB issued guidance on leases. This standard requires the recognition of a right-of-use asset and lease liability on the balance sheet for all leases. This standard also requires more detailed disclosures to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. This guidance is effective for interim and annual reporting periods beginning after December 15, 2018 and should be applied through a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, and early adoption is permitted. We expect to adopt this guidance on January 1, 2019. We have not yet determined the impact the adoption of this guidance will have on our financial position, results of operations or cash flows.

In January 2016, the FASB issued guidance on the recognition and measurement of financial instruments. This standard requires equity investments, except those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in fair value recognized in net income. This standard also requires the separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017, early adoption is permitted, and the guidance must be applied prospectively to equity investments that exist as of the adoption date. We expect to adopt this guidance on January 1, 2018. We have not yet determined our approach to adoption or the impact the adoption of this guidance will have on our financial position, results of operations or cash flows.

In November 2015, the FASB issued guidance on the balance sheet classification of deferred taxes. This standard requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. This guidance is effective for interim and annual reporting periods beginning after December 15, 2016, and early adoption is permitted. We adopted this guidance for the year ended December 31, 2015 on a retrospective basis. The adoption of this guidance has not had any impact on our financial position, results of operations or cash flows.

In September 2015, the FASB issued guidance on simplifying the accounting for measurement-period adjustments in business combinations. This standard requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined.

This guidance is effective for interim and annual reporting periods beginning after December 15, 2015, and early adoption is permitted. We adopted this guidance for the year ended December 31, 2015. The adoption of this guidance has not had a material impact on our financial position, results of operations or cash flows.

In April 2015, the FASB issued guidance related to a customer s accounting for fees paid in a cloud computing arrangement. This standard provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This guidance is effective for interim and annual reporting periods beginning after December 15, 2015, and early adoption is permitted. We adopted this guidance on January 1, 2016. The adoption of this guidance has not had any impact on our financial position, results of operations or cash flows.

In August 2014, the FASB issued guidance on the disclosure of uncertainties about an entity s ability to continue as a going concern. This standard provides guidance about management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and to provide related footnote disclosures. The guidance is effective for annual reporting periods ending after December 15, 2016, and early adoption is permitted. We expect to adopt this guidance on January 1, 2017. We do not expect the adoption of this guidance to have any impact on our financial position, results of operations or cash flows.

In May 2014, the FASB issued guidance on revenue recognition. This guidance provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The original effective date of this guidance was for interim and annual reporting periods beginning after December 15, 2016, early adoption is not permitted, and the guidance must be applied retrospectively or modified retrospectively. In July 2015, the FASB approved an optional one-year deferral of the effective date. As a result, we expect to adopt this guidance on January 1, 2018. In 2016, the FASB issued final amendments to clarify the implementation guidance for principal versus agent considerations, identifying performance obligations and the accounting for licenses of intellectual property. We have not yet determined our approach to adoption or the impact the adoption of this guidance will have on our financial position, results of operations or cash flows, if any.

Note 3. Fair Value Measurements

Accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The standards also establish a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Assets and liabilities valued based on observable market data for similar instruments, such as quoted prices for similar assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity; instruments valued based on the best available data, some of which is internally developed, and considers risk premiums that a market participant would require.

We applied the following methods and assumptions in estimating our fair value measurements: