

ZILLOW INC
Form 10-Q
August 06, 2014
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 June 30, 2014

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

Commission File Number: 001-35237

ZILLOW, INC.

(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	20-2000033 (I.R.S. Employer Identification Number)
1301 Second Avenue, Floor 31, Seattle, Washington (Address of principal executive offices)	98101 (Zip Code)

(206) 470-7000

<https://twitter.com/zillow>

(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 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 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 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

As of July 31, 2014, 34,118,777 shares of Class A common stock and 6,217,447 shares of Class B common stock were outstanding.

Table of Contents

ZILLOW, INC.

Quarterly Report on Form 10-Q

For the Three Months Ended June 30, 2014

TABLE OF CONTENTS

	Page
<u>PART I FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (unaudited)</u>	2
<u>Condensed Consolidated Balance Sheets</u>	2
<u>Condensed Consolidated Statements of Operations</u>	3
<u>Condensed Consolidated Statements of Cash Flows</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	28
Item 4. <u>Controls and Procedures</u>	29
<u>PART II OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	30
Item 1A. <u>Risk Factors</u>	31
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	43
Item 4. <u>Mine Safety Disclosures</u>	43
Item 6. <u>Exhibits</u>	44
<u>Signatures</u>	45

Table of Contents

As used in this Quarterly Report on Form 10-Q, the terms Zillow, the Company, we, us and our refer to Zillow, 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 proposed acquisition of Trulia, Inc.; our ability to maintain and effectively manage an adequate rate of growth; the impact of the real estate industry on our business; our ability to innovate and provide products and services that are attractive to our users and advertisers; our ability to increase awareness of the Zillow brand in a cost-effective manner; our ability to maintain or establish relationships with listings and data providers; our ability to attract consumers to our mobile applications and websites; our ability to compete successfully against existing or future competitors; the reliable performance of our network infrastructure and content delivery process; and our ability to protect our intellectual property. Further discussion of factors that may affect our business and results of operations is included in Part II, Item 1A (Risk Factors) in this Quarterly Report on Form 10-Q. 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.zillow.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.

Investors and others should note that we announce material financial information to our investors using our investor relations website, press releases, SEC filings, and public conference calls and webcasts. We also use the following social media channels as a means of disclosing information about the company, our services, and other matters, and for complying with our disclosure obligations under Regulation FD:

Zillow Twitter Account (<https://twitter.com/zillow>)

Zillow Facebook Page (<https://www.facebook.com/Zillow>)

Zillow Company Blog (<http://www.zillowblog.com/>)

The information we post through these social media channels may be deemed material. Accordingly, investors should monitor these accounts and the blog, in addition to following our investor relations website, 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.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements (unaudited)****ZILLOW, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data, unaudited)

	June 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 138,289	\$ 201,760
Short-term investments	219,777	93,531
Accounts receivable, net of allowance for doubtful accounts of \$2,490 and \$1,850 at June 30, 2014 and December 31, 2013, respectively	19,885	15,234
Prepaid expenses and other current assets	6,464	4,987
Total current assets	384,415	315,512
Long-term investments	99,806	142,435
Property and equipment, net	34,011	27,408
Goodwill	96,352	93,213
Intangible assets, net	26,455	29,149
Other assets	434	346
Total assets	\$ 641,473	\$ 608,063
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	\$ 14,279	\$ 4,724
Accrued expenses and other current liabilities	12,116	10,601
Accrued compensation and benefits	6,363	4,440
Deferred revenue	14,037	12,298
Deferred rent, current portion	735	546
Total current liabilities	47,530	32,609
Deferred rent, net of current portion	10,248	7,658
Commitments and contingencies (Note 11)		
Shareholders equity:		
Preferred stock, \$0.0001 par value; 30,000,000 shares authorized as of June 30, 2014 and December 31, 2013; no shares issued and outstanding as of June 30, 2014 and December 31, 2013	3	3

Edgar Filing: ZILLOW INC - Form 10-Q

Class A common stock, \$0.0001 par value; 600,000,000 shares authorized as of June 30, 2014 and December 31, 2013; 34,045,698 and 32,934,074 shares issued and outstanding as of June 30, 2014 and December 31, 2013, respectively

Class B common stock, \$0.0001 par value; 15,000,000 shares authorized as of June 30, 2014 and December 31, 2013; 6,217,447 and 6,468,892 shares issued and outstanding as of June 30, 2014 and December 31, 2013, respectively

	1	1
Additional paid-in capital	684,548	651,913
Accumulated deficit	(100,857)	(84,121)
Total shareholders' equity	583,695	567,796
Total liabilities and shareholders' equity	\$ 641,473	\$ 608,063

See accompanying notes to condensed consolidated financial statements.

Table of Contents**ZILLOW, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share data, unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue	\$ 78,675	\$ 46,920	\$ 144,918	\$ 85,886
Costs and expenses:				
Cost of revenue (exclusive of amortization) (1)	6,793	4,294	12,957	8,424
Sales and marketing	48,075	32,924	82,973	52,718
Technology and development	19,862	11,071	36,832	21,682
General and administrative	14,706	8,978	29,395	17,211
Total costs and expenses	89,436	57,267	162,157	100,035
Loss from operations	(10,761)	(10,347)	(17,239)	(14,149)
Other income	284	115	503	170
Net loss	\$ (10,477)	\$ (10,232)	\$ (16,736)	\$ (13,979)
Net loss per share basic and diluted	\$ (0.26)	\$ (0.30)	\$ (0.42)	\$ (0.41)
Weighted-average shares outstanding basic and diluted	39,800	34,553	40,314	34,164
(1) Amortization of website development costs and intangible assets included in technology and development	\$ 6,857	\$ 4,492	\$ 13,641	\$ 8,700

See accompanying notes to condensed consolidated financial statements.

Table of Contents**ZILLOW, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands, unaudited)**

	Six Months Ended June 30,	
	2014	2013
Operating activities		
Net loss	\$ (16,736)	\$ (13,979)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	16,670	9,934
Share-based compensation expense	15,542	14,613
Loss on disposal of property and equipment	353	668
Bad debt expense	1,225	765
Deferred rent	2,779	(122)
Amortization of bond premium	1,751	210
Changes in operating assets and liabilities:		
Accounts receivable	(5,876)	(5,193)
Prepaid expenses and other assets	(1,565)	(462)
Accounts payable	9,555	2,659
Accrued expenses	3,438	(1,506)
Deferred revenue	1,739	959
Net cash provided by operating activities	28,875	8,546
Investing activities		
Proceeds from maturities of investments	73,885	33,000
Purchases of investments	(159,253)	(56,272)
Purchases of property and equipment	(15,373)	(10,996)
Purchases of intangible assets	(2,132)	(1,707)
Cash paid for acquisition	(3,500)	
Net cash used in investing activities	(106,373)	(35,975)
Financing activities		
Proceeds from exercise of Class A common stock options	14,027	8,941
Net cash provided by financing activities	14,027	8,941
Net decrease in cash and cash equivalents during period	(63,471)	(18,488)
Cash and cash equivalents at beginning of period	201,760	150,040
Cash and cash equivalents at end of period	\$ 138,289	\$ 131,552
Supplemental disclosures of cash flow information		
Noncash transactions:		
Capitalized share-based compensation	\$ 3,086	\$ 1,732

Write-off of fully depreciated property and equipment	\$ 3,017	\$ 792
---	----------	--------

See accompanying notes to condensed consolidated financial statements.

Table of Contents

ZILLOW, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Organization and Description of Business

Zillow, Inc. was incorporated as a Washington corporation effective December 13, 2004, and we launched the initial version of our website, Zillow.com, in February 2006. Zillow 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. In addition to our living database of homes, accessible on Zillow.com, we also own and operate Zillow Mobile, our suite of home-related mobile applications, Zillow Mortgage Marketplace, where borrowers connect with lenders to find loans and get competitive mortgage rates, Zillow Digs, our home improvement marketplace where consumers can find visual inspiration and local cost estimates, Zillow Rentals, a marketplace and suite of tools for rental professionals, Postlets, Diverse Solutions, Agentfolio, Mortech, HotPads, StreetEasy and Retsly. Zillow provides products and services to help consumers through every stage of homeownership — buying, selling, renting, borrowing and remodeling.

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: 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; acquisitions and investments; 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, Inc. and our wholly-owned subsidiary, Zillow (Canada), Inc. 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, 2013 included in the Company's Annual Report on Form 10-K, which was filed with the SEC on February 18, 2014. The condensed balance sheet as of December 31, 2013, included herein, was derived from the audited financial statements as of that date.

The unaudited condensed consolidated interim financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial position as of June 30, 2014, our results of operations for the three and six month periods ended June 30, 2014 and 2013, and our cash flows for the six month periods ended June 30, 2014 and 2013. The results of the three and six month periods ended June 30, 2014 are not necessarily indicative of the results to be expected for the year ended December 31, 2014 or for any interim period or for any other future year.

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. Estimates are used for revenue recognition, the allowance for doubtful accounts, website development costs, goodwill, recoverability of intangible assets with definite lives and other long-lived assets, and for share-based compensation. To the extent there are material differences between these estimates, judgments, or assumptions and actual results, our financial statements will be affected.

Table of Contents***Reclassifications***

Certain immaterial reclassifications have been made to conform data for prior periods to the current format.

Recently Issued Accounting Standards

In July 2013, the Financial Accounting Standards Board (FASB) issued guidance on the presentation of certain unrecognized tax benefits in the financial statements. This guidance provides that a liability related to an unrecognized tax benefit must be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. This guidance is effective for interim and annual reporting periods beginning after December 15, 2013, with earlier adoption permitted, and may be applied prospectively or retrospectively. We adopted this guidance on January 1, 2014. The adoption of this guidance did not have a significant impact on our financial position, results of operations or cash flows, as we have provided a full valuation allowance against our net deferred tax assets.

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. This guidance is effective for interim and annual reporting periods beginning after December 15, 2016, early adoption is not permitted, and must be applied retrospectively or modified retrospectively. We expect to adopt this guidance on January 1, 2017. We have not yet determined 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:

Cash equivalents Cash equivalents are comprised of highly liquid investments, including money market funds, municipal securities and certificates of deposit with original maturities of less than three months. The fair value measurement of our cash equivalents is based on quoted prices in active markets for identical assets.

Short-term and long-term investments Our investments consist of fixed income securities, which include U.S. government agency securities, corporate notes and bonds, municipal securities, certificates of deposit and commercial paper. Investments with maturities greater than three months but less than one year are classified as short-term investments. Investments with maturities greater than one year are classified as long-term investments. The fair value measurement of these assets is based on observable market-based inputs or inputs that are derived principally from or corroborated by observable market data by correlation or other means. Our short-term and long-term investments are classified as held-to-maturity and are recorded at amortized cost, as we do not intend to sell the investments, and it is not more likely than not that we will be required to sell these investments prior to maturity. The amortized cost of our short-term and long-term investments approximates their fair value.

Of the short-term investments and long-term investments on hand as of June 30, 2014, 68.8% mature on or prior to June 30, 2015, and the remaining 31.2% mature on or prior to June 30, 2016.

Table of Contents

The following tables present the balances of cash equivalents and investments as of the dates presented (in thousands):

	June 30, 2014		
	Total	Level 1	Level 2
Cash equivalents:			
Money market funds	\$ 125,685	\$ 125,685	\$
Short-term investments:			
U.S government agency securities	139,707	139,707	
Corporate notes and bonds	36,086		36,086
Municipal securities	15,952		15,952
Certificates of deposit	14,055		14,055
Commercial paper	13,977		13,977
Long-term investments:			
Corporate notes and bonds	47,394		47,394
U.S. government agency securities	27,768	27,768	
Certificates of deposit	23,197		23,197
Municipal securities	1,447		1,447
Total	\$ 445,268	\$ 293,160	\$ 152,108

	December 31, 2013		
	Total	Level 1	Level 2
Cash equivalents:			
Money market funds	\$ 184,941	\$ 184,941	\$
U.S government agency securities	3,306	3,306	
Short-term investments:			
U.S government agency securities	78,448	78,448	
Commercial paper	3,998		3,998
Corporate notes and bonds	11,085		11,085
Long-term investments:			
U.S government agency securities	112,623	112,623	
Corporate notes and bonds	29,812		29,812
Total	\$		