Zillow

D/G to Neutral as housing recovery priced in, commission suits a valuation overhang

Rating Change: NEUTRAL | PO: 60.00 USD | Price: 54.35 USD

10 January 2024

Equity

Downgrade Zillow to Neutral

We downgrade Zillow to Neutral (from Buy) as we believe the stock is pricing a steady recovery in housing in 2024 (shares are up over 40% y/y), near record low home affordability could limit volume upside (even w/ lower rates) and real estate commission lawsuits are an overhang on ZG's buy side agent lead generation segment (nearly 50% of revs). We expect a beat in 4Q23 on improved home vols and are inline with the Street for '24 revs, but see risk to EBITDA (we are 8% below Street) on what could be optimistic OPEX ests.

Growth initiatives likely more impactful in 2025/26

The past year and a half marked strong execution and renewed share gains for Zillow. As comps get more difficult in 2024, we believe outperformance will be increasingly dependent on initiatives under the housing "super app" and rollout of enhanced markets that incorporate super app features. We remain confident that these initiatives will drive growth but expect more contribution in 2025/26 as rollout continues through '24.

Commission lawsuits drive uncertainty for buyside revs.

We think the Sitzer case and other commission lawsuits could be a headwind to ZG's buy side lead generation segment. Risks are: 1) a reduction in total agents on lower earning potential, particularly as transactions per agent are now 50% below 24yr avg and 2) Lower commission dollars on increased fee transparency and uncertainty on who will bear the buyside commission. We do not expect a banning of commission sharing from the suits (which could be a major headwind to ZG revs and burden to homebuyers) and expect ZG to successfully adapt to changes on revenue diversification. However, we expect uncertainty to be an overhang on valuation until more clarity is brought on the issue, starting with a final verdict for Sitzer in April. Resolution/appeal of the suits or minimal changes to agent commission structure would be a positive for ZG shares.

Rolling forward valuation to 2025; Raising PO to $60

We raise our PO to $60 (from $47) as we move our basis forward to 2025 but lower our PO multiple to 20x (inline with historic average) from 22x. Lower rates are supportive of higher valuation but offset by uncertainty from the commission lawsuits. We raise our estimates to factor slightly higher real estate transaction growth in 4Q23 and 2024. For 2024, we raise our revenue ests. by 3% to $2.1bn and EBITDA by 5% to $456mn.

Estimates (Dec) (US$)	**2021A**	**2022A**	**2023E**	**2024E**	**2025E**
EPS	(0.84)	1.71	1.22	1.19	2.02
GAAP EPS	(2.05)	(0.42)	(0.77)	(0.86)	(0.14)
EPS Change (YoY)	NM	NM	-28.7%	-2.5%	69.7%
Consensus EPS (Bloomberg)			0.97	1.11	1.69
DPS	0	0	0	0	0
EPS (Z - US$)	(0.84)	1.71	1.22	1.19	2.02
DPS (Z - US$)	0	0	0	0	0
Valuation (Dec)					
P/E	NM	31.8x	44.5x	45.7x	26.9x
EV / EBITDA*	49.2x	22.1x	34.1x	28.8x	19.8x
Free Cash Flow Yield*	-25.1%	33.9%	2.2%	2.6%	5.0%

* For full definitions of *IQmethod* SM measures, see page 13.

Key Changes

(US$)	Previous	Current
Inv. Opinion	C-1-9	C-2-9
Inv. Rating	BUY	NEUTRAL
Price Obj.	47.00	60.00
2023E Rev (m)	1,922.8	1,929.6
2024E Rev (m)	2,043.6	2,106.0
2025E Rev (m)	2,351.3	2,423.0
2024E EPS	1.17	1.19
2025E EPS	1.96	2.02

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Stock Data

Price (NAS / NAS)	54.35 USD / 55.44 USD
Price Objective	60.00 USD / 60.00 USD
Date Established	10-Jan-2024 / 10-Jan-2024
Investment Opinion	C-2-9 / C-2-9
52-Week Range	33.23 USD - 58.82 USD
Market Value (mn)	12,936 USD
Free Float	67.9%
Average Daily Value	46.74 USD
Shares Outstanding (mn)	238.0 / 238.0
BofA Ticker / Exchange	ZG / NAS
BofA Ticker / Exchange	Z / NAS
Bloomberg / Reuters	ZG US / ZG.OQ
ROE (2023E)	6.7%
Net Dbt to Eqty (Dec-2022A)	4.3%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

OPEX – operating expenses

Refer to important disclosures on page 14 to 17. Analyst Certification on page 12. Price Objective Basis/Risk on page 12.
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Timestamp: 10 January 2024 06:00AM EST

iQprofile SM Zillow

*iQ*method SM – Bus Performance*

(US$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	-4.0%	-0.7%	-3.9%	-3.5%	-0.8%
Return on Equity	-4.3%	8.4%	6.7%	6.9%	12.3%
Operating Margin	-4.0%	-1.0%	-10.2%	-5.2%	3.1%
Free Cash Flow	(3,250)	4,389	287	330	651

*iQ*method SM – Quality of Earnings*

(US$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	NM	10.9x	1.4x	1.7x	1.7x
Asset Replacement Ratio	0.6x	0.7x	0.7x	0.7x	0.7x
Tax Rate	NM	NM	NM	NM	NM
Net Debt-to-Equity Ratio	-1.6%	4.3%	2.2%	15.1%	18.6%
Interest Cover	-1.7x	-0.8x	-7.5x	-6.0x	-1.3x

Income Statement Data (Dec)

(US$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	8,147	6,184	1,930	2,106	2,423
% Change	143.9%	-24.1%	-68.8%	9.1%	15.1%
Gross Profit	1,788	1,834	1,611	1,783	2,083
% Change	18.4%	2.6%	-12.2%	10.7%	16.9%
EBITDA	267	596	386	456	663
% Change	-22.0%	122.9%	-35.3%	18.3%	45.3%
Net Interest & Other Income	(199)	(38)	86	17	14
Net Income (Adjusted)	**(215)**	**415**	**291**	**279**	**467**
% Change	**NM**	**NM**	**-30.0%**	**-4.1%**	**67.6%**

Free Cash Flow Data (Dec)

(US$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	(528)	(101)	(183)	(201)	(33)
Depreciation & Amortization	130	157	182	195	210
Change in Working Capital	0	0	0	0	0
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(2,779)	4,448	422	476	624
Capital Expenditure	(73)	(115)	(133)	(140)	(150)
Free Cash Flow	**-3,250**	**4,389**	**287**	**330**	**651**
% Change	**NM**	**NM**	**-93.5%**	**15.0%**	**97.3%**
Share / Issue Repurchase	127	46	66	60	(40)
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	0	0	0	0

Balance Sheet Data (Dec)

(US$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	2,611	1,466	1,570	477	361
Trade Receivables	155	72	73	85	97
Other Current Assets	4,687	2,063	1,641	1,662	1,573
Property, Plant & Equipment	215	271	347	448	556
Other Non-Current Assets	3,028	2,691	2,723	2,724	2,724
Total Assets	**10,695**	**6,563**	**6,354**	**5,395**	**5,310**
Short-Term Debt	1,209	0	607	0	0
Other Current Liabilities	2,674	270	360	375	389
Long-Term Debt	1,319	1,660	1,057	1,057	1,057
Other Non-Current Liabilities	152	151	129	129	129
Total Liabilities	**5,354**	**2,081**	**2,153**	**1,561**	**1,575**
Total Equity	**5,341**	**4,482**	**4,201**	**3,834**	**3,748**
Total Equity & Liabilities	**10,695**	**6,563**	**6,354**	**5,395**	**5,323**

* For full definitions of *iQmethod* SM measures, see page 13.

Company Sector

Internet/e-Commerce

Company Description

Zillow Group (ZG/Z) is the category leader for online real estate advertising with over 300mn average monthly unique users across multiple sites. Zillow operates the top two online and mobile real estate lead generating services Zillow.com and Trulia.com, as well as high growth segments in rentals and mortgage lead generation. We believe Zillow occupies a lucrative position in the market relative to competitors due to its dominant and growing share of user traffic and advertiser spending

Investment Rationale

Given Zillow's sizable real estate-focused audience, we are positive on its ability to expand share in home-related markets such as real estate, rentals, and mortgage and through several initiatives that should increase agent productivity. However, in the near- to medium-term, we believe uncertainty over mounting real estate commission lawsuits could be disruptive to ZG's buy side revs (nearly 50% of total) and weigh on investor sentiment.

Stock Data

Average Daily Volume	860,055
Shares / Common - Dual Listed	1.00

Quarterly Earnings Estimates

	2022	2023
Q1	0.56A	0.37A
Q2	0.50A	0.42A
Q3	0.41A	0.35A
Q4	0.22A	0.09E

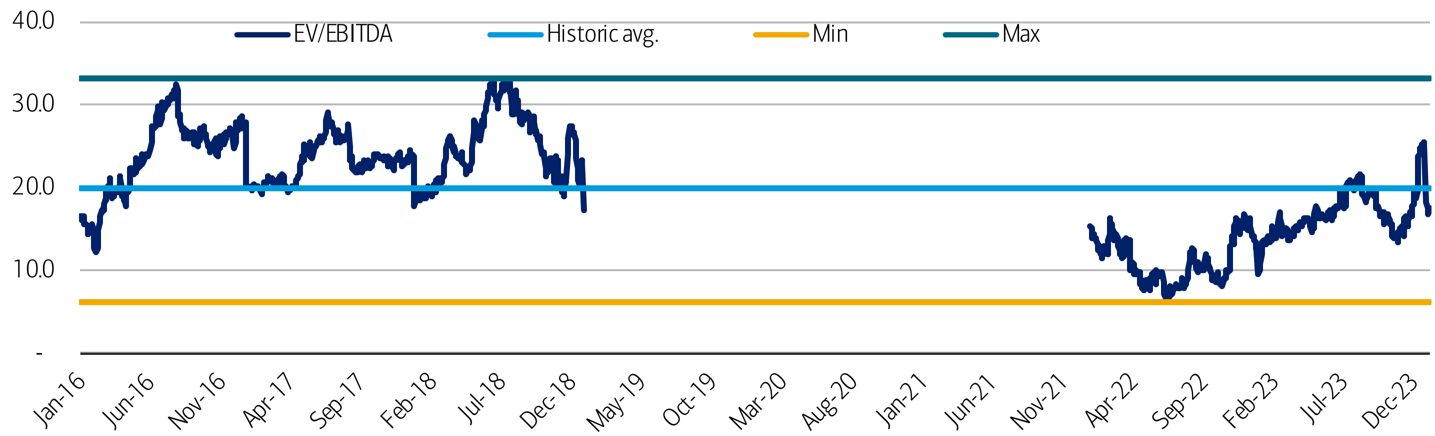
Key Changes

(US$)	Previous	Current
Inv. Opinion	C-1-9	C-2-9
Inv. Rating	BUY	NEUTRAL
Price Obj.	47.00	60.00
2024E EPS	1.17	1.19
2025E EPS	1.96	2.02

Downgrade ZG to Neutral, raise PO to $60

We downgrade Zillow (ZG/Z) to Neutral as we believe the stock is pricing a steady recovery in housing in 2024 (shares are up over 40% y/y), near record low home affordability could limit volume upside (even w/ lower rates) and real estate commission lawsuits are an overhang on ZG's buy side agent lead generation segment (nearly 50% of revs). We also expect growth initiatives to gradually build in 2024 after material share gains in 2023. Resolution/appeal of the suits or minimal changes to agent commission structure would be a positive for ZG shares.

Exhibit 1: 2yr EV/EBITDA trend
Zillow is trading inline with its historic valuation range



Source: Bloomberg, BofA Global Research | *excludes period for discontinued Zillow Homes Segment

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We raise our estimates to factor slightly higher real estate transaction growth in 4Q23 and 2024 (we now forecast +1.8% YoY in 2024 from -0.4% prior and maintain ~11% growth in 2025). For 4Q23, we raise our revenue estimates to $459mn from $447mn and maintain EBITDA at $64mn. For 2024, we raise our revenue/EBTIDA estimates to $2,106mn/$456mn from $2,044mn/$435mn. For 2025, we now estimate revenue/EBITDA of $2,423mn/$663mn from $2,351mn/$636mn.

We raise our PO to $60 (from $47) as we move our basis forward to 2025 but lower our PO multiple to 20x (inline with historic average) from 22x. While a nearly 100bp drop in interest rates is supportive of higher sector valuations and an improving real estate market, uncertainty over several high profile class action lawsuits that could significantly disrupt buy side agent commissions (accounts for nearly 50% of Zillow revenues) are a risk to earnings and investor sentiment and overhang on valuation.

Exhibit 2: Zillow BofA estimates vs. consensus
We are slightly above Street for 2024 Revenue but below for EBITDA.

BofA vs. Street	4Q-23			1Q-24			FY-24			FY-25		
Zillow ($mn)	BofA	Street	Diff	BofA	Street	Diff	BofA	Street	Diff	BofA	Street	Diff
Residential	340	330	3%	354	368	-4%	1,542	1,536	0%	1,773	1,741	2%
Rentals	90	90	0%	91	91	0%	421	408	3%	484	473	2%
Mortgage	20	20	1%	25	28	-11%	103	111	-7%	124	138	-10%
Other	9	10	-7%	10	9	4%	40	42	-3%	42	44	-4%
Total Revenue	459	449	2%	479	496	-4%	2,106	2,097	0%	2,423	2,395	1%
Gross profit	362	352	3%	378	392	-4%	1,675	1,674	0%	1,963	1,925	2%
Gross margin	79%	78%	60bps	79%	79%	2bps	80%	80%	-35bps	81%	80%	63bps
EBITDA	64	57	12%	93	110	-16%	456	484	-6%	663	664	0%
EBITDA Margin	14%	13%	119bps	19%	22%	-282bps	22%	23%	-142bps	27%	28%	-34bps

Source: BofA Global Research, Visible Alpha

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Share gains more measured in ’24 as initiatives build

The past year and a half marked a period of strong execution and renewed share gains for Zillow after several years of inconsistent results and exiting the loss-marking iBuying business. Better than expected results and outperformance to the market, which topped 19ppts in 2Q23 (relative to existing home transactions) were largely driven by “meat & potato” improvements (better buyer segmentation and coverage, quicker agent connections and improved touring integration) as well an uptick in activity from first-time homebuyers in early-to-mid-2023. With comps getting more difficult in 2024, we believe outperformance to the market will be increasingly dependent on several key growth initiatives under Zillow’s housing “super app” and rollout of enhanced markets that fully incorporate all super app features. This includes enhanced real time home tour booking under ShowingTime, the expansion of Zillow Home Loans, the integration of the recently acquired real estate CRM tool Follow Up Boss and Listing Showcase tool for listing agents.

We remain confident that these initiatives will be important revenue drivers for Zillow but expect them to be more impactful in 2025 and 2026 as the rollout of many products will continue through 2024. Zillow management has not given a timeline for the full deployment of the super app but noted that 2023 would be “a year to release new products and test in various markets” which would setup for “further scaling into 2024 and 2025”. Below we provide a progress summary for key components of the super app:

1) **Touring:** Under ShowingTime (acquired in Oct. 2021), the dominant online home tour booking service, Zillow expects to have real-time booking available to 10% of connections by the end of 2023. We see real-time tour booking as a key productivity driver for Zillow’s buy-side lead generation business (nearly 50% of revenues) as people who request a tour are three times as likely to purchase a home.

2) **Financing:** Zillow’s mortgage origination business, Zillow Home Loans will likely take time to scale as the company continues to build the infrastructure and workforce and establish relationships with agents in markets. Home Loans is currently being rolled out in enhanced markets and we expect a full launch by 2025. As of 3Q23, originations grew 35% QoQ and 88% YoY, albeit on a low base. We see the mortgage business as another way for Zillow to deliver high-intent leads to buy-side agent customer given that 80% of homebuyers utilize a mortgage.

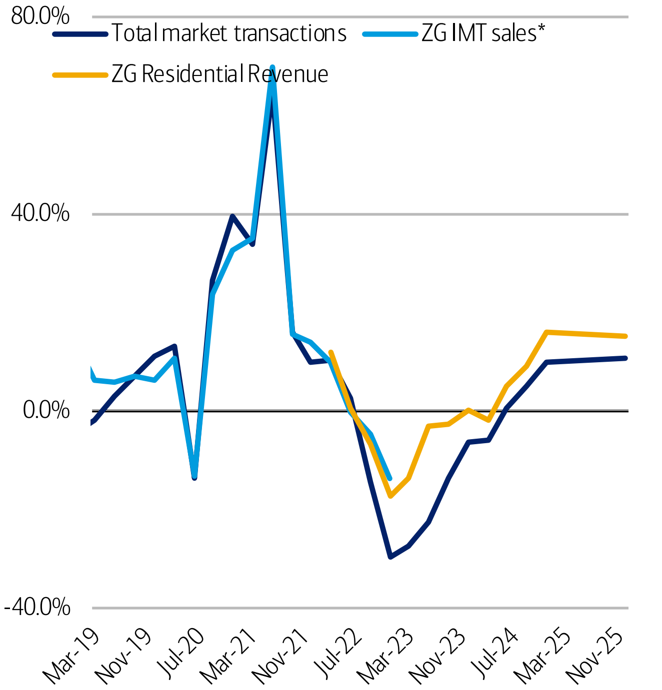
3) **Seller Solutions:** In June, Zillow unveiled Listing Showcase, a service under ShowingTime+ that helps listing agents better promote their brand and listings and driven by high-resolution scrolling images, room-by-room photo organization and sellers' homes appearing higher in-home shoppers' personalized search results. As of 3Q23, Listing Showcase was in 17 markets and will continue to expand through 2024. We see this as an important tool to grow sell side revenues where we estimate Zillow has only 1% transaction share compared to 5% on the buy side.

4) **Enhanced markets:** Zillow has established nine enhanced markets as of 3Q23 (total number of markets not disclosed) and plans to accelerate new market launched through 2024.

5) **Rentals:** Rentals listings are an established business for Zillow (18% of revenues) but we see it as an important source of growth for 2024 and beyond. Rental revenues grew 34% YoY in 3Q23 and we believe growth in the 20%+ range is possible in 2024 on increasing vacancies, slowing pricing and new builds as well as increased inventory on ZG’s site.

Our estimates assume outperformance to our housing transaction forecasts of 4/4/5/6ppts in 1Q24-4Q24 compared to 6ppts in 4Q23 implied by guidance and 11pts in 3Q23.

Exhibit 3: Existing home transactions vs. ZG revenues (YoY%)
ZG has outpaced the market since late 2022



Source: Bloomberg, company reports, BofA Global Research | *will cease reporting in 2024
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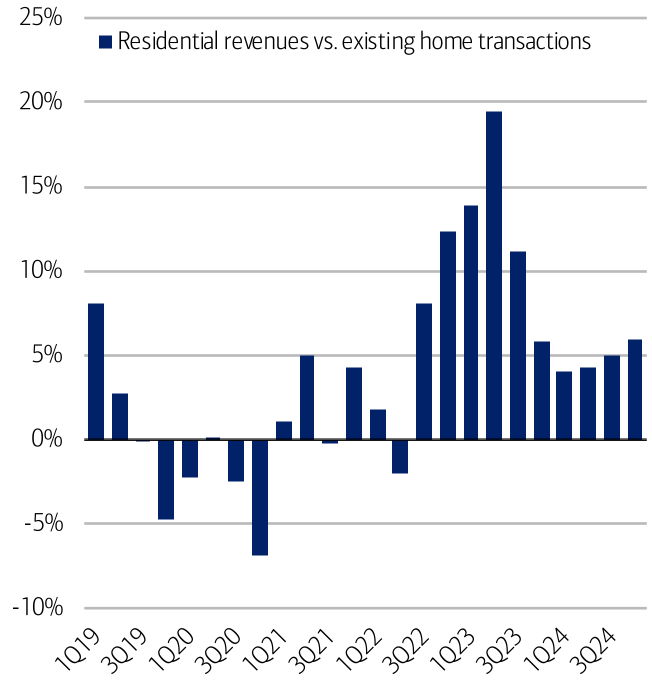
Exhibit 4: Zillow Residential revenues vs. existing home transactions
We expect outperformance to continue albeit at lower levels in 2024



Source: Bloomberg, company reports, BofA Global Research
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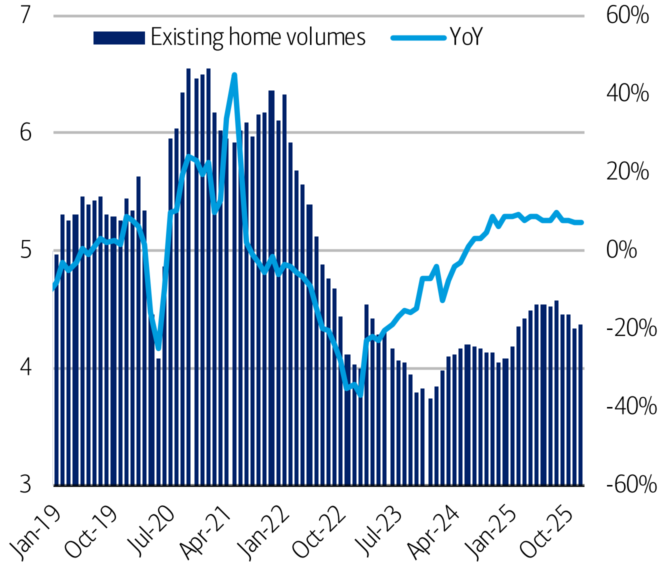
Rates provide relief but affordability still a strain on vols

After two years of double-digit declines, we expect flat existing home volumes in 2024 (assuming a return to YoY growth in 2H) and 8% growth in 2025 on high underlying demand for homes 100bps of improvement in 30yr fixed mortgage rates since a peak in October. While this represents an increase from our prior 2024 volume forecast for a 1.5% decline and current volumes are 30% below the average since 2000, we believe further upside could be limited. The housing market remains in a very tight balance between high demand, low supply, and resilient pricing. On the home buyer side, lower rates present some relief, but affordability remains at record lows following a 44% increase in existing home prices since 2019. On the sell seller side, home supply is constrained after nearly two decades of underbuilding new homes and with more than 80% of mortgages under 5% (vs. 6.9% now), new listing growth may be continue to limited by "rate-locked" owners.

Exhibit 5: Monthly existing home volumes (mn's) and Y/Y % change
We expect steady improvement in volumes but expect trends to remain below historic levels



Source: Bloomberg, BofA Global Research

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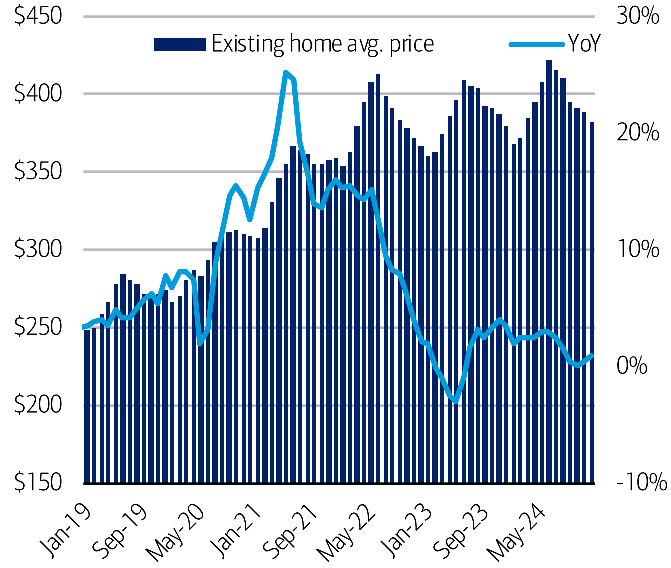
Exhibit 6: Monthly existing home average price (000's) and Y/Y % change
Home prices have accelerated as mortgage rates have compressed



Source: Bloomberg, BofA Global Research

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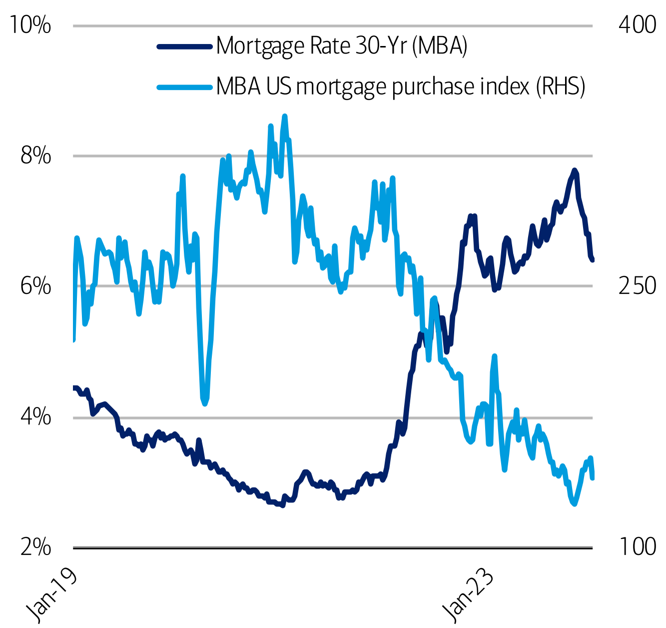
Perspective home buyers already appear to be reacting to the recent drop-in mortgage rates with the MBA home purchase index (a helpful predictor for existing home sales) increasing from a record low of 125 in late October to 141 at the end of December (though still well below an avg. of 248 since 1990). Our forecasts factor lower rates (including a 6.5% 30yr by the end of 2024) with volumes improving from -7.3% YoY in Nov. 2023 to -4% in January and +9% by Dec. 2024.

Exhibit 7: MBA purchase index and 30-Yr fixed mortgage rate
Mortgage purchase applications have rebounded with a decline in rates



Source: Bloomberg

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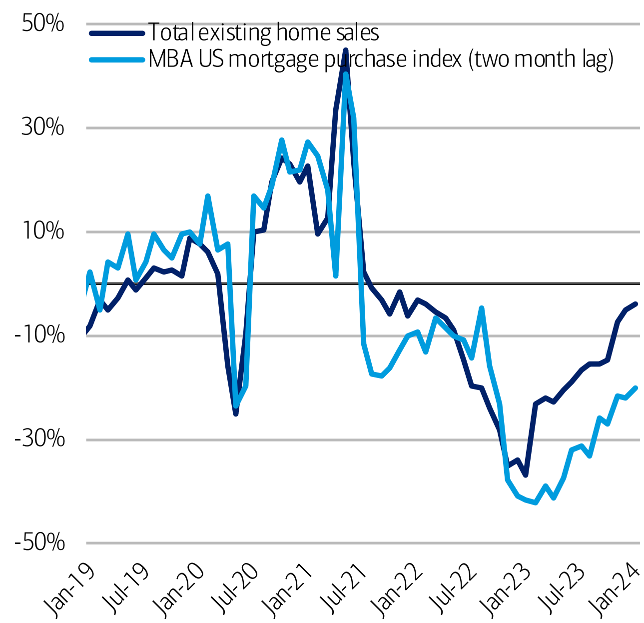
Exhibit 8: Existing home vols vs. mortgage purchase applications YoY
On a YoY basis mortgage activity is still gradually improving



Source: Bloomberg

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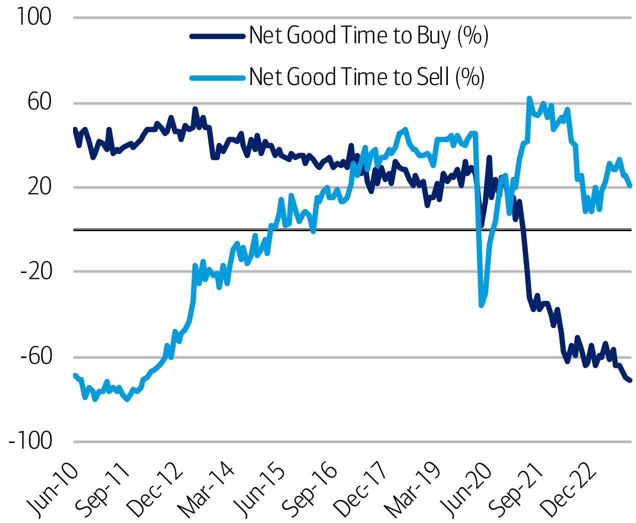
While housing conditions are improving, many home buyers and still appear to be hesitant to transact. Per Fannie Mae, the number of home buyers who believe it's a good time to buy hit a record low of -71 in November and the number of home sellers who believe it's a good time to sell fell to 21 from 33 in August. This is reflected in the latest home inventory metrics with current existing home supply at 3.4 months, improved from a record low of 1.7 months in Feb. 2022 but well below the historic average of 5.30.

Exhibit 9: Fannie Mae net good time to buy vs. sell surveys

Prospective home buyers & sellers remain cautious on market conditions



Source: Bloomberg

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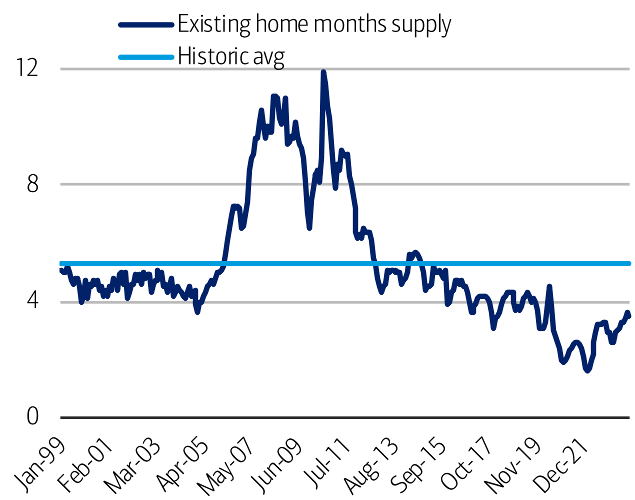
Exhibit 10: Existing home months supply

While significantly improved from post-COVID lows, home supply is 33% below the historic average



Source: Bloomberg

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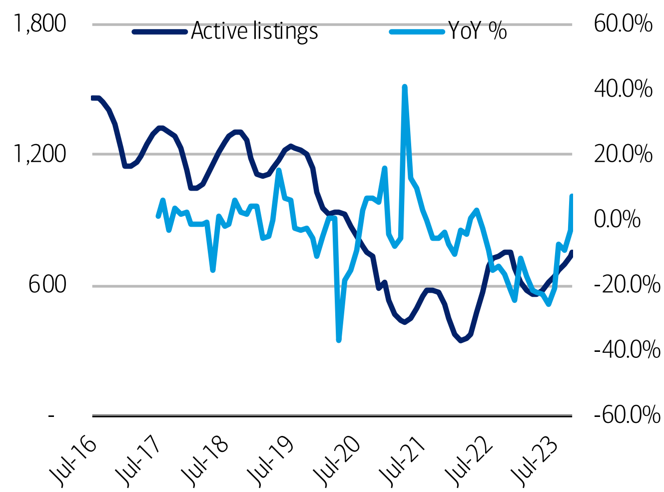
Home listing data from Realtor.com shows similar trends with supply beginning to improve but well belove historic levels. Home listings totaled 755k in November vs. a low of 347k in Feb. 2022 but 38% below the pre-COVID average of 1.2mn. With lower rates, we expect listing trends to improve through 2024 but expect a gradual process given the number of homeowners with mortgages well below the current rate.

Exhibit 11: Active US home listings (thousands)

Listings have improved in 2H23 but are well below historic trends



Source: Realtor.com

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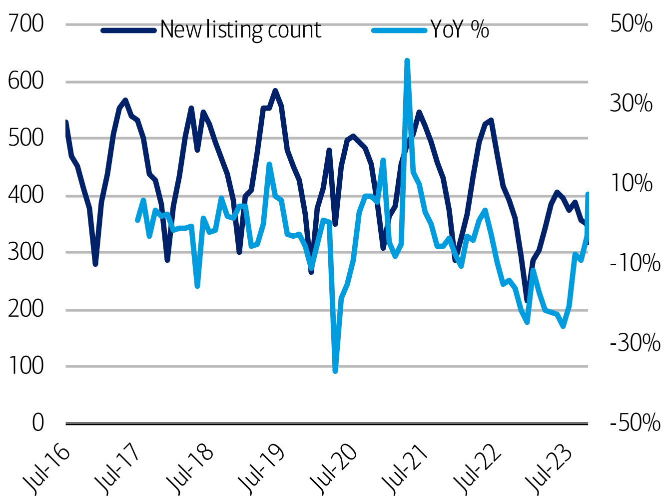
Exhibit 12: New US home listings (thousands)

Supply appears to be driven by more new homes on the market



Source: Realtor.com

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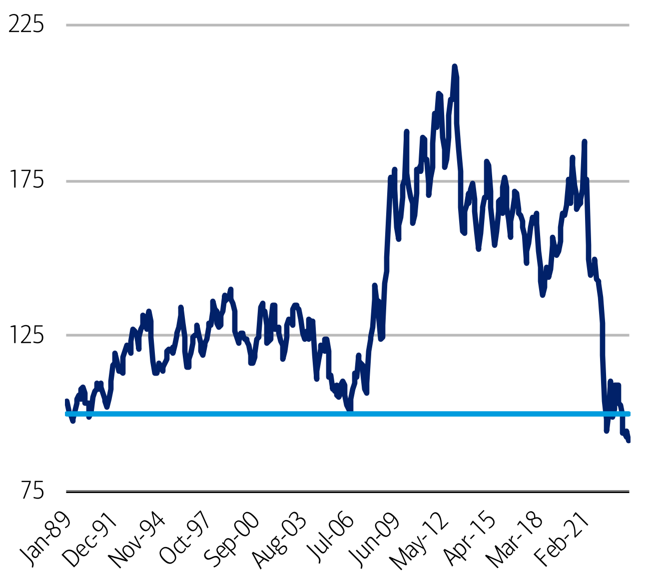
Pending a significant increase in new home listings which would presumably put pressure on home prices or a material drop in mortgage rates, we believe affordability will remain a challenge for many home buyers through 2024. Per the National Association of Realtors, housing affordability is at the lowest level in at least 35 years and less than half the rate in early 2021 preceding a nearly 50% increase in home prices. While affordability likely troughed in October when mortgage rates hovered at 8%, at the current rate of ~7% and avg. existing home value of $388k, the monthly cost of a 30yr mortgage is double the amount at the end of 2019. We also expect new home sales to be advantaged over existing home in 2024 given better relative supply and pricing for the former. Homebuilders have been able to improve the relative affordability of new homes through downsizing builds, mortgage rate buy downs and select price decreases. This was led to a narrowing of the new to existing price premium to ~10% in November vs. a long-term average of 20%. The ratio of new to existing home has also increased to a near record of 31% compared to a long term average ranging from 10-20%.

Exhibit 13: National Association of Realtors: Housing Affordability Index*

Lower rates have provided some relief but the cost 30yr mortgage is still twice as high as 2019



Source: Bloomberg | *a value of 100 means that a family with the median income has exactly enough income to qualify for a mortgage on a median-priced home. An index above 100 signifies that family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home, assuming a 20 percent down payment

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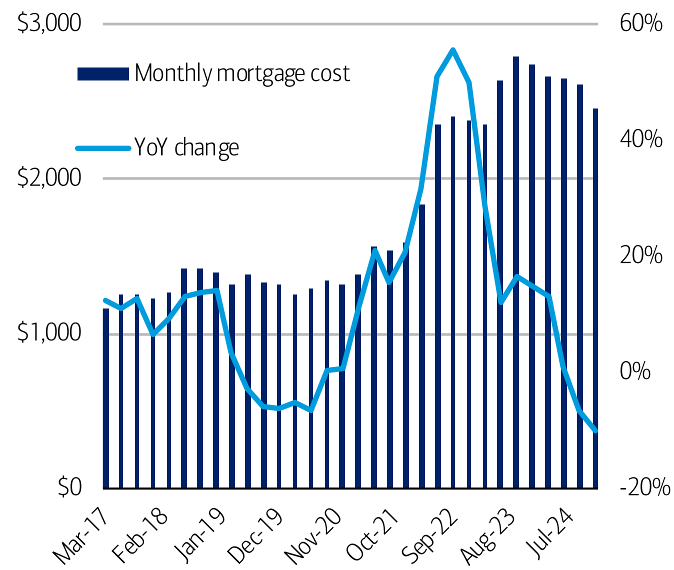
Exhibit 14: Monthly cost of a 30yr fixed mortgage

Lower rates have provided some relief but the cost 30yr mortgage is still twice as high as 2019



Source: Bloomberg, BofA Global Research | *calculated using avg. existing home price and 30yr mortgage rate for period

BofA GLOBAL RESEARCH

Commission lawsuits drive uncertainty for buyside revs

In late Oct'23, Missouri jury ruled against the National Association of Realtors (NAR) and several major real estate brokerages (HomeServices of America and Keller Williams) in the Sitzer Burnett trial. The case was based on a NAR policy known as the "compensation cooperation rule" where homes listed on multiple listing services (aka MLS, databases for home listings) were required to offer commission compensation to buyside real estate agents. The juror ruled that the policy had "the purpose or effect of raising, inflating, or stabilizing broker commission rates paid by home sellers". The defendants have been ordered to pay damages of $1.78bn. Treble damages could result in the NAR and brokerages paying roughly $5.36bn. Though a final judgment in the case has yet to be issued (expected in mid-April), the jury awarded the plaintiffs damages of ~$1.78bn, which Judge has the option to triple in his final ruling, meaning that the defendants might be on the hook for more than $5.36bn. Following the jury ruling, NAR released a statement noting its plans to appeal the verdict, but that process could take years to resolve.

Sitzer Burnett final verdict not expected until mid-April 2024

Post-trial motions in the Sitzer Burnett case are expected to last at least through March 2024 and according to legal experts, finally ruling on the case is not expected until mid-April 2024 at the earliest. We don't expect a major deviation from the initial ruling given separate settlements for Anywhere and RE/MAX (both were parties in the case), which prohibited the compensation cooperation rule requirement but did not ban commission sharing.

Anywhere & RE/MAX settlement could receive final court approval in mid-2024

In Nov'23, Anywhere and RE/MAX received preliminary court approval of their nationwide agreement to settle all claims in the Burnett, Moehrl, and Nosalek and other similar antitrust class action litigation. As part of the settlement, Anywhere agreed to provide monetary relief of $83.5mn and injunctive relief, requiring practice changes in Anywhere Advisors, the Company's owned brokerage operations, which includes Coldwell Banker Realty, Corcoran, and Sotheby's International Realty, for a period of five years following final court approval of the settlement. RE/MAX agreed to pay $55mn and make changes to business practices as part of the settlement According to press reports, final court approval of both the settlements is expected in mid-2024.

Other similar lawsuits and potential implications

Moehrl case

Among the many lawsuits filed on similar grounds to Sitzer Burnett, one of the case that could have most significant implications is Moehrl case, with defendants including National Association of Realtors (NAR), Keller Williams and HomeServices of America (Anywhere and RE/MAX are no longer included given Sitzer settlement). Originally filed in 2019, the class action lawsuit alleges that the National Association of Realtors, along with the "Big Four" — Anywhere, HomeServices of America, RE/MAX and Keller Williams, violated federal antitrust law by conspiring to require home sellers to pay buyer's broker's commissions at inflated rates.

NAR rules that required all brokers to offer buyer broker compensation when listing a property on MLS, saying this has driven up costs to the seller and stifled competition. The complaint reads, "Because most buyer brokers will not show homes to their clients where the seller is offering a lower buyer broker commission, or will show homes with higher commission offers first, sellers are incentivized when making the required blanket, non-negotiable offer to procure the buyer brokers' cooperation by offering a high commission". The lawsuit also says it will represent any home sellers who sold property and paid a broker commission in the last four years in specific geographic areas covered by different regional MLSs. This includes areas in Texas, Maryland, North Carolina, Ohio, Colorado, Michigan, Florida, Nevada, Wisconsin, Minnesota, Pennsylvania, Arizona, Virginia, Utah and the District of Columbia.

In May 2023, A federal appeals court denied a request from defendants to overturn the class certification of the case. Now, the case is likely headed to trial, but no date has been set as the defendants seek to resolve some individual claims in arbitration. According to press reports, Potential damages in the case could go as high as $40bn.

Gibson case

This case was filed by the lead attorney in Sitzer Burnett case on the same day (Oct 31) of favorable jury verdict. The lawsuit expands the scope to a nationwide class action representing all homebuyers and sellers allegedly harmed by NAR policies. It primarily focuses on the buyer broker commission rule and "Clear Cooperation Policy," mirroring the antitrust concerns from Sitzer Burnett case. Including NAR, the lawsuits names seven defendant brokerages including Compass., Weichert Realtors, and Redfin, and seek damages of more than $100bn.

DOJ files to reopen investigation into NAR for anticompetitive practices

In 2019, DOJ and FTC launched a joint investigation into NAR's rules on commissions and buyer broker compensation alleging anticompetitive practice. The DOJ alleges NAR policies like the buyer broker commission rule and "Clear Cooperation Policy" artificially inflate commission rates, harming competition and driving up home prices for buyers. NAR argues these policies benefit consumers by ensuring transparency and collaboration. The DOJ also expressed concerns about NAR's restrictions on broker access to multiple listing services (MLSs), potentially limited consumer choice and information while NAR argued these rules protect IP and ensure data accuracy.

In 2020, DOJ reached a settlement agreement with NAR, requiring changes to its policies to increase transparency and competition. Notably, this included allowing brokers to disclose commission offers publicly. However, in 2021, when Biden administration took office, their stance on the DOJ-NAR settlement shifted significantly on grounds that it didn't adequately address competition concerns and DOJ opted to withdraw from the settlement. Shortly after withdrawing from the settlement, the DOJ also resumed its investigation into NAR, including the Participation Rule that's also at the center of many consumer-led lawsuits. Since 2021, NAR has argued in court that the original settlement should stand. In 2022, a federal court sided with NAR, forcing the DOJ to uphold the settlement. However, the decision was appealed by DOJ. On Dec 1, 2023, The U.S. Court of Appeals in Washington D.C. heard oral arguments about whether DOJ can reopen an antitrust case NAR. Recently, the plaintiffs' attorneys in the Sitzer Burnett case have also been in talks with the DOJ. We think If the DOJ is successful in reopening this case, it could force greater disruption on the real estate industry than any of the consumer-led commission lawsuits.

Implications for Zillow

For Zillow, major potential risks from all these cases could include:

- A potentially large reduction in total agents on lower earning potential, particularly as transactions per agent are now 50% below the 24yr avg and,
- Lower commission dollars on fee transparency and uncertainty on who will bear the buyside commission (currently funded by sellers)
- Other industry wide implications could include: 1) more commission transparency and 2) changes to national MLS, and 3) additional copycat lawsuits being filed in other states

We think the outcome of the Sitzer Burnett case could be a headwind to the commission pool that feeds the Zillow's lead generation segment for buy side agents. Currently, Zillow derives slightly less than 50% of sales from the "premier agent" lead generation segment that is supported by buyside fees. Based on an average transaction fee of 5% (and a 50/50 split by agents), we estimate the total current buyside commission pool is $40bn, equating to $12bn available for marketing purposes (using a standard 30% referral fee for leads & vs. premier agent revs of ~$1.1bn). If average buyside commissions were 2%, the pool for marketing would be $9.5bn (~20% lower) and at 1% it would be $4.8bn (~60% lower). In our view, ZG has some insulation due to a strategy of shifting to the highest productivity agents and several initiatives to increase lead conversion rates, but lower commissions and total agents are no doubt a risk. The ruling also puts more onus on scaling sell-side services and rentals which are a priority for ZG management.

Given the disruption potential for the real estate industry from the Sitzer Burnett case and other similar cases, we see near-term risk to Zillow's buyside revenues. We believe Zillow would be able to successfully adapt to potential changes given: 1) strong user engagement and usage of the platform (Zillow remains the real estate site in the US); 2) a strategy to shift more business to largest and most productive agents and; 3) Acquisitions such as ShowingTime and Follow Up Boss and focus on new growth initiatives positions the company well for long-term sell side growth exposure, which should mitigate the impact of loss of revenue from buyside agents.

Price objective basis & risk

Zillow (ZG / Z)

Our $60 price objective for both Class A (ticker ZG) and Class C (ticker Z) shares is based on a 20x EV/EBITDA estimate, in line with ZG's average historic EBITDA multiple. Our 20x multiple is above the peer lead generation average of 14x given our forecast for double EBTIDA margins and growth in 2024-25.

Downside risks are: 1) a slower than expected recovery in the US housing market, 2) potential disruption to buy side revenues from several agent commission lawsuits and 3) execution risk around new growth initiatives and 4) increased competition from Costar's new residential advertising marketplace.

Upside risks are: 1) faster-than-expected growth and S&M leverage,2) better than expected trends in the US existing home market on lower rates, and 3) faster than expected progress in ZG hitting its long term targets.

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US - Internet Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Alphabet	GOOGL	GOOGL US	Justin Post
	Alphabet	GOOG	GOOG US	Justin Post
	Amazon.com	AMZN	AMZN US	Justin Post
	AppLovin	APP	APP US	Omar Dessouky, CFA
	DoorDash	DASH	DASH US	Michael McGovern
	Electronic Arts	EA	EA US	Omar Dessouky, CFA
	Expedia	EXPE	EXPE US	Justin Post
	LegalZoom	LZ	LZ US	Michael McGovern
	Match Group	MTCH	MTCH US	Curtis Nagle, CFA
	Meta Platforms Inc	META	META US	Justin Post
	Pinterest	PINS	PINS US	Justin Post
	RH	RH	RH US	Curtis Nagle, CFA
	Roblox Corp. Class A	RBLX	RBLX US	Omar Dessouky, CFA
	Squarespace, Inc.	SQSP	SQSP US	Michael McGovern
	Uber	UBER	UBER US	Justin Post
	Udemy Inc	UDMY	UDMY US	Curtis Nagle, CFA
	Vivid Seats	SEAT	SEAT US	Curtis Nagle, CFA
	Wayfair	W	W US	Curtis Nagle, CFA
	Wix.com	WIX	WIX US	Michael McGovern
NEUTRAL				
	ACV Auctions	ACVA	ACVA US	Curtis Nagle, CFA
	Airbnb	ABNB	ABNB US	Justin Post
	Beyond Inc	BYON	BYON US	Curtis Nagle, CFA
	Booking Holdings Inc	BKNG	BKNG US	Justin Post
	Bumble	BMBL	BMBL US	Curtis Nagle, CFA
	Digital Turbine, Inc	APPS	APPS US	Omar Dessouky, CFA
	Duolingo	DUOL	DUOL US	Curtis Nagle, CFA
	eBay	EBAY	EBAY US	Justin Post
	Etsy, Inc.	ETSY	ETSY US	Curtis Nagle, CFA
	Instacart	CART	CART US	Justin Post
	Playtika	PLTK	PLTK US	Omar Dessouky, CFA
	Snap	SNAP	SNAP US	Justin Post
	Take-Two Interactive	TTWO	TTWO US	Omar Dessouky, CFA
	Zillow	ZG	ZG US	Curtis Nagle, CFA

US - Internet Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Zillow	Z	Z US	Curtis Nagle, CFA
UNDERPERFORM				
	Chewy Inc	CHWY	CHWY US	Curtis Nagle, CFA
	Lyft, Inc.	LYFT	LYFT US	Michael McGovern
	Opendoor Technologies	OPEN	OPEN US	Curtis Nagle, CFA
	Peloton	PTON	PTON US	Curtis Nagle, CFA
	Redfin Corp	RDFN	RDFN US	Curtis Nagle, CFA
	Shutterstock	SSTK	SSTK US	Curtis Nagle, CFA

*iQ*method SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings	**Numerator**	**Denominator**
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt – Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	**Numerator**	**Denominator**
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price × Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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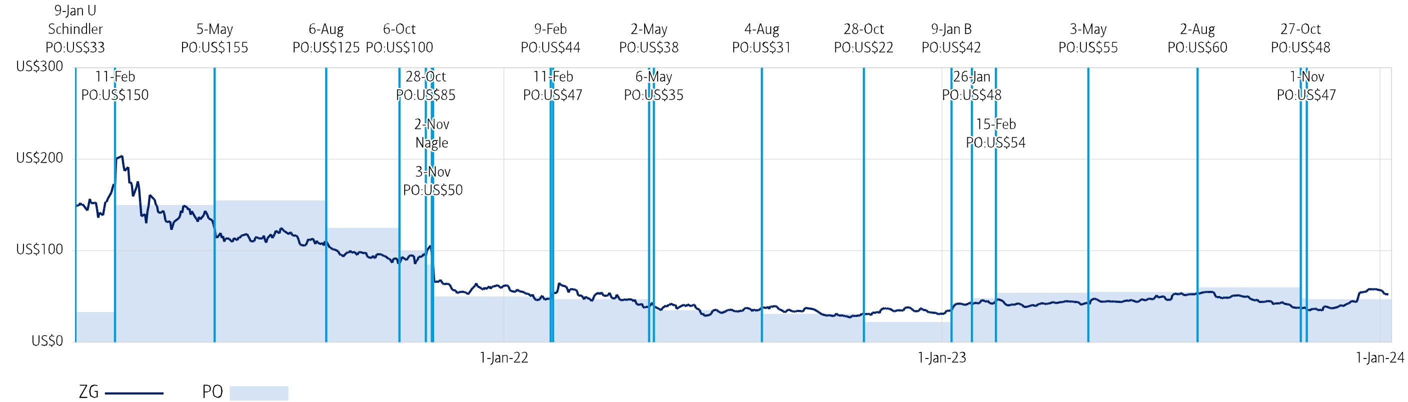
Zillow A (ZG) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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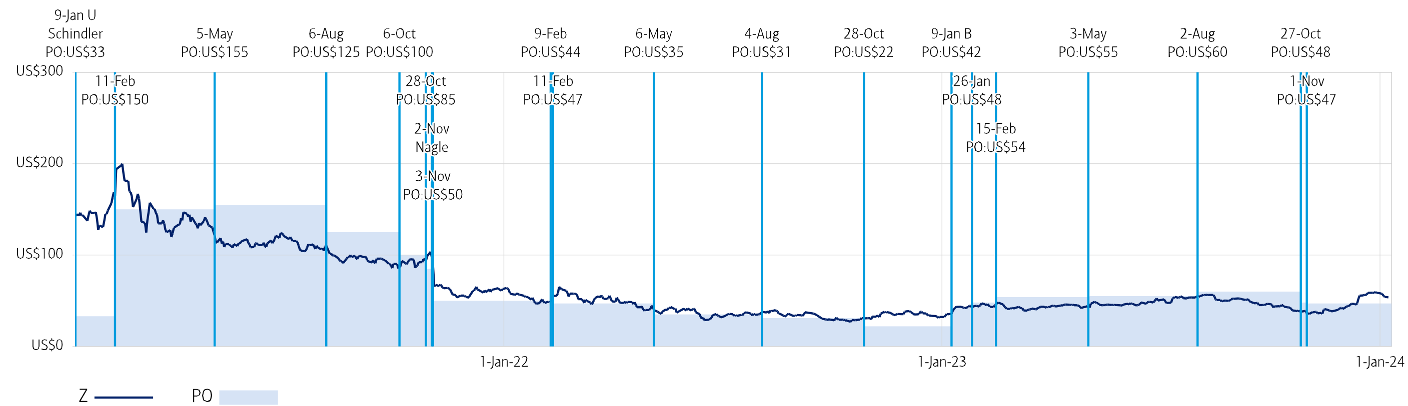
Zillow C (Z) Price Chart



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Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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