Redfin Corporation (RDFN)

Incentives, Lions, & Creating The Real Estate Brokerage Of The Future

Redfin (RDFN) is a residential real estate brokerage that helps people buy and sell homes. The company's mission is to redefine real estate in the consumer's favor. This means offering the lowest fees of any real estate brokerage in the country.

For example, RDFN charges a 1-1.5% seller's commission versus the industry-standard 5-6%. Since launching in 2006, RDFN has saved its customers nearly $1B in commissions over 310,000 transactions. RDFN's ruthless focus on consumer savings is working. The company's more than doubled its market share from 0.44% to 1.00% since 2015, growing revenues from $187M to $886M.

Most investors see RDFN as just another real estate brokerage business clawing for more of the $93B addressable market. But RDFN isn't just another brokerage. Instead, **it's fundamentally changing how consumers buy and sell homes.**

There are only two assumptions that matter to the RDFN thesis:

1. Real estate commissions will go to zero.
2. The way consumers buy/sell homes in ten years will look vastly different than today.

RDFN is the best option for both the real estate agent and the consumer. For consumers, the company sells homes faster *and* for more money than the industry average. Moreover, agents working at RDFN can earn 2x more money and close 3x the deals.

> *Our Variant Perception: If real estate commissions go to zero, agents will join a brokerage that offers security, inbound deal flow, and transaction bonuses tied to deal closures (not home prices). RDFN is the only company that's built a business model around a salaried agent.*
>
> *More agents on the RDFN payroll means more homes viewed, sold, and bought through the RDFN platform. In addition, more homes on its platform allow RDFN to cross-sell other services like mortgages, title insurance, and iBuying. In turn, RDFN takes the entire home buying/selling process and creates a seamless, online-first experience for its customers at the lowest cost possible.*

RDFN plays the long (and harder) game by building a real estate brokerage focused on the consumer with full-time salaried agents. As a result, they're slow to enter new markets, opting for a test and deploy strategy over the traditional "move fast and break things" Silicon Valley mantra.

Yet if anyone can do it, it's RDFN's CEO Glenn Kelman. Kelman is one of the sharpest CEOs we've seen in any company. He's passionate about changing real estate in the consumer's favor and pays

himself a meager $300K annual salary. Kelman's favorite saying is "everyone sweeps the floors at Redfin." We *love* partnering with those types of CEOs.

RDFN is in the early innings of building the next-generation real estate brokerage business. The company designed its business to make the consumer the customer, not the real estate agent. We **see a path towards $100+/share prices and an 18% 10YR IRR if it executes its strategy.**

Redfin's Business Model: It's All Table Stakes

RDFN has a straightforward business model. There are three ways a homeowner can sell their property on RDFN:

- **Redfin Brokerage:** RDFN lists the home and charges a 1.5% seller's fee (vs. 5-6% traditional seller's commission)
- **Redfin Concierge:** RDFN fixes up the home and lists it for a 2.5% fee (which is still lower than traditional brokerage fees)
- **RedfinNOW**: RDFN buys the home outright for a 6-12% fee

The company generates 75% of its revenue from its brokerage services segment.

Selling homes is the tip of the iceberg. RDFN wants to own the entire home sale process, giving customers a one-stop solution. So along with its brokerage business, RDFN offers *Redfin Mortgage* and *Title Forward.* These "Other" services allow customers to buy, finance, and get title insurance, all inside the RDFN platform.

Revenue ($ in millions)

Legend: Real estate services, Properties, Other*

	2015	2016	2017	2018	2019	2020
Total	$187	$267	$370	$487	$780	$886
Other*						
Properties				$45	$241	$210
Real estate services	$181	$260	$352	$432	$524	$651

	2015	2016	2017	2018	2019	2020
Real estate services % growth	49%	44%	35%	23%	21%	24%
Total % growth	49%	43%	38%	32%	60%	14%

RDFN's final revenue source is its *RedfinNow* iBuying business. Like Zillow (ZG) or OpenDoor (OPEN), *RedfinNOW* buys properties from sellers, fixes them up, and sells them back to home buyers on its platform. RDFN's grown its iBuying segment from $45M in revenue in 2018 to $210M in 2020 (2020 dampened due to COVID).

iBuying is a highly cyclical business with myriad risks. It requires loads of cash and generates ~1.5-2% operating margins. In short, it's not a great business. RDFN is likely using it as a loss-leader to bring more homes into the platform and provide greater liquidity to its customers.

It's important to note that **everything to this point is table stakes in the real estate business**, from brokerage services to iBuying to 3D Matterport virtual tours. They're the ante needed to see the flop.

What distinguishes RDFN from every other broker is how the company creates better customer incentives.
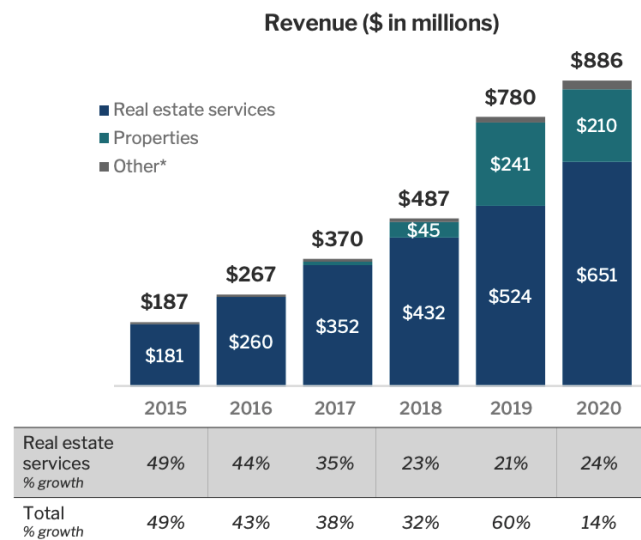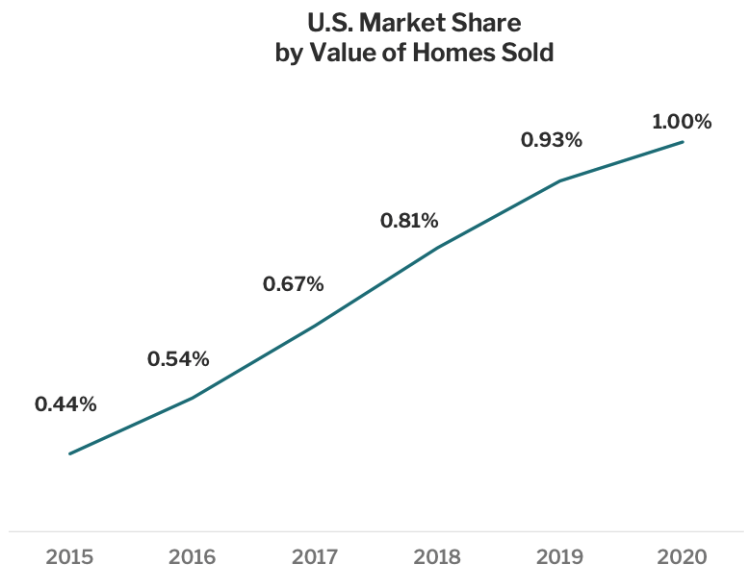
Redfin Creates The Best Customer Incentives Possible

RDFN's business places the consumer, *not* the real estate agent, as the customer. A difference so subtle most investors miss it. But it's one of the most critical aspects of the RDFN bull thesis. Let's compare RDFN to a traditional brokerage business.

Traditional brokerages place the real estate agent as the customer. These agents eat what they kill. Most times, there's no base salary or health benefits, and the take-home pay is directly correlated to the size of the commission check. This dynamic incentivize agents to get the highest price possible for each home sold.

But what happens to the *actual* customer -- the consumer buying or selling the home? They pay more in fees. The buyer pays more for the house she wants.

One of Charlie Munger's most famous quotes is, *"show me the incentives and I'll show you the outcome."* The traditional brokerage model incentivizes higher prices, higher fees, and outcomes favor the real estate agent. RDFN has the opposite incentive structure.

U.S. Market Share by Value of Homes Sold

Year	Market Share
2015	0.44%
2016	0.54%
2017	0.67%
2018	0.81%
2019	0.93%
2020	1.00%

It's *this* structure that enables RDFN to modernize and transform the entire home buying/selling process. But, again, returning the incentives and savings back to the *actual* customer, the consumer.

RDFN hires its own real estate agents and compensates them with full-time salaries, health benefits, and transaction bonuses. Since consumers visit RDFN to buy and sell homes, RDFN's agents don't need to "eat what they kill."

The company aggregates demand for them. In turn, the agent is incentivized to close as many deals as possible, not to get the highest sales price feasible. As a result, the buyer receives a fair price, the seller pays less in commissions, and the agent collects a capped transaction bonus. It's a win-win-win.

You can start to see how powerful this incentive realignment is for RDFN's long-term competitive advantage. As a result, traditional brokerages must completely overhaul their business models to compete with RDFN.

Brokerages would have to cut agent commissions per transaction, pay agents a salary, *and* aggregate demand so its agents could close more deals. Most traditional brokerages couldn't survive the cost structure shift.

One company that could compete with RDFN is Zillow, yet Zillow hasn't shown any desire to match RDFN's model. So in a way, Zillow's backed themselves into a corner with their existing model. Zillow makes gobs of cash from real estate agents paying Zillow to list homes on its site.

If they were to switch to a consumer-first brokerage model, sure, they would have an edge in lead generation. Still, they would lose arguably their largest cash-generating customer. Not to mention the massive capital investment required to build out an internal real estate agent staff with full-time salaries and benefits. That's not a switch Zillow wants to make.

RDFN now has a structural advantage over every single peer in its industry by going slow and building the harder-to-duplicate business model. So what are real estate agents supposed to do in a zero commission environment? Where do they turn? Our bet is they turn to RDFN.

Redfin Is The Most Logical Choice For The 130K Independent Agents

One of our two pillars to the RDFN thesis is that **seller's agent commissions will go to zero at some point**. We have no idea *when* that will happen. But there's one thing we do know: VC dollars and FinTech platforms have a $93B market to take their cut (5-6% of $1T+ existing home sales market).

RDFN is the only brokerage offering the 130K independent agents a way to live in a 0% commission environment. Excluding the 0% commission environment, there are a few reasons why agents will choose RDFN. Let's start with lion hunting habits.

Better Agents, Better Service
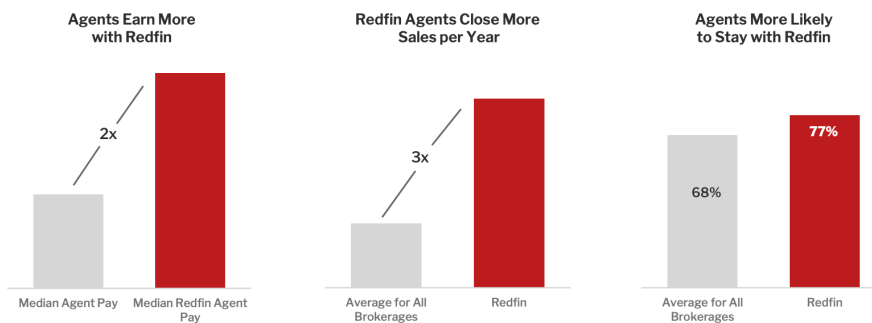
Traditional brokerage agents are like female lions. The lioness spends her day stalking prey, coordinating with other lionesses to kill the next meal. It's an exhausting endeavor with no guarantee of success.

Like the lioness, traditional agents hunt for their meals, corraling as much inbound traffic as they can generate, and pounce on the highest-commission opportunity. There's no guaranteed bi-weekly check.

RDFN agents are more like male lions. They wait in heavy vegetation for the prey to come to them. Then, when in striking distance, they take the kill shot. Similarly, RDFN agents get an inbound deal flow and then decide which deals to close.

The RDFN offering is a no-brainer for independent real estate agents. You get a full-time salary, health benefits, and transaction bonuses with seemingly unlimited inbound deal flow.

Agents are 77% more likely to stay with RDFN than the average brokerage. This makes sense because the average RDFN agent makes twice as much money and closes three times as many deals.

More agents on the RDFN platform create a lasting network effect that will grow stronger over the next decade.

Redfin's Durable Network Effect Advantages

It's easy to see RDFN's network effect but hard to appreciate the magnitude of its advantage. RDFN agents list their homes on the RDFN platform. So the more agents RDFN gets on the payroll, the more homes it will list on its platform.

More homes bring more buyers to its platform, allowing RDFN to sell more homes faster than its peers. The more homes it sells on the platform, the more significant savings it generates for its customers. In turn, these customers will likely use RDFN for their next purchase or sale, which creates customer lock-in.

In fact, RDFN has a 54% higher repeat rate (buyers using the same brokerage to sell the home they bought) than its industry.

A Slow-Growing, Highly Cyclical Business

RDFN isn't a "move fast and break things" type of company. Glenn Kelman prefers deliberate, highly-tested hypotheses before making decisions. For example, the company is only in 95 markets currently. Kelman isn't in any rush to enter new markets for the sake of growth.

He explained his process on a podcast, saying (and I'm paraphrasing): *"We had to get the website perfect, just right. We weren't launching in that area until we made it perfect."* The end goal is a $93B addressable market. So there is room to grow slowly, getting the product *just right*.

The company is a real estate brokerage company dressed in a tech company's clothes. Q2 - Q3 is usually better than Q1 and Q4. Moreover, RDFN's iBuying program will generate high but lumpy revenues with minimal positive margin impact.

Thinking About Valuation

As we mentioned earlier, RDFN's current market price assumes a ~20% 10YR revenue growth CAGR and 12% run-rate EBITDA margins. To get a 20% 10YR CAGR, Mr. Market's assuming only 5% annual revenue growth after 2025.

Again, that seems highly unlikely given the competitive advantages and the industry's eventual shift to low commissions and online-first shopping. In the above scenario, RDFN would end 2030 with $5.4B in revenue.

If we assume ~30% gross margins, we get ~$1.62B in gross profit and $670M in EBITDA (12% margin). Now, let's assume RDFN grows revenue at ~20% from 2026 - 2030. That gives us $10.4B in 2030 revenue and $1.3B in EBITDA. At 5x gross profit, you get ~$15B in Enterprise Value and ~$144/share in shareholder value for an 18% 10YR IRR.

Concluding Thoughts

RDFN is redefining real estate in the consumer's favor. They're lowering fees and making it easier than ever to buy and sell homes. Over time, the real estate industry's 5-6% commissions will compress to zero. When that happens, RDFN will become the most logical choice for the 130K independent real estate agents to continue selling homes.

This will bring more homes to RDFN and increase the value of its platform to both buyers, sellers, and agents. The company is run by one of the sharpest, honest operators in Glenn Kelman.

RDFN is the only real estate company creating the brokerage business of the future. From its cost structure to its agent incentives, the entire company is built for the next generation of home buyers and sellers. As a result, the company will continue to take market share from its competitors for the next few decades.